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Do Class Action Lawyers Make Too Little?

Brian T. Fitzpatrick

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DO CLASS ACTION LAWYERS MAKE TOO LITTLE?

BRIAN T. FITZPATRICK[†]

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INTRODUCTION

Class action lawyers are some of the most frequently derided players in our system of civil litigation.¹ The focus of this ire is usually the

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¹ See Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. CHI. LEGAL F. 71, 117 (“[P]ublic attitudes about plaintiffs’ class action lawyers have often been strongly negative”); Trisha L. Howard, *More Lawyers Cash in on Class-Actions*, ST. LOUIS POST-DISPATCH, June 22, 2003, at

"take" that class action lawyers receive from class action settlements.² It is often asserted that class action lawyers take too much from settlements and leave too little for class members, that class actions are little more than a device for the lawyers to enrich themselves at the expense of the class.³ These criticisms have inspired countless calls for reform of class action litigation,⁴ and indeed, some of these calls have found their way into legislation.⁵ In this Article, I argue that much of this criticism of class action lawyers is misguided. In particular, I assert that, in many cases, class action lawyers not only do not make too much, but actually make too little. Indeed, I argue that in perhaps the most common class action—the so-called "small stakes" class action—it is hard to see, as a theoretical matter, why the lawyers should not receive everything and leave nothing for class members at all.

Unlike in individual litigation, where lawyers and their clients can negotiate how they will split litigation proceeds, class action lawyers litigate on behalf of parties in absentia. As a result, third parties must decide how much to pay class action lawyers, and, in our system, these third parties are judges. According to empirical research I recently

C1, available at 2003 WLNR 16136526 ("[Class action lawyers] are the epitome of lawyers who do things for huge sums of money." (quoting Lawrence Schonbrun)).

² See, e.g., Third Circuit Task Force on Selection of Class Counsel, *Third Circuit Task Force Report on Selection of Class Counsel*, 74 TEMP. L. REV. 689, 692 (2001) ("[T]here is a perception among a significant part of the non-lawyer population and even among lawyers and judges that the risk premium is too high in class action cases and that class action plaintiffs' lawyers are overcompensated for the work that they do."); Rocco Cammarere, *The Dichotomy of Class Actions*, N.J. LAW., Sept. 11, 2000, at 1 ("[T]here's that pervasive criticism—lawyers earn scads of money for doing relatively little work.").

³ See, e.g., John H. Beisner et al., *Class Action "Cops": Public Servants or Private Entrepreneurs?*, 57 STAN. L. REV. 1441, 1445 (2005) ("[O]ne of the most heavily criticized class action abuses has been the use of class action settlements to generate huge fees for lawyers and little or nothing for the allegedly injured consumers."); Bruce L. Hay, *The Theory of Fee Regulation in Class Action Settlements*, 46 AM. U. L. REV. 1429, 1433 (1997) ("Among critics, the contention that class members have received too little in a class settlement almost always is accompanied by the corresponding charge that the class' counsel has received too much . . ."); Joseph Perkins, *Judicial Shakedown by Class-Action Lawyers*, SAN DIEGO UNION-TRIB., Mar. 22, 2002, at B11, available at 2002 WLNR 13947222 (noting that the sponsors of a bill in the U.S. House of Representatives that targeted the "questionable practices" of class action lawyers commented that "attorneys frequently reap millions in fees while class members are shortchanged").

⁴ See, e.g., Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1102 (1996) (advocating "subsequent suits against class counsel . . . to deter class action misconduct").

⁵ See, e.g., Class Action Fairness Act of 2005, Pub. L. No. 109-2, 119 Stat. 4 (codified in scattered sections of 28 U.S.C.) ("[This is] [a]n Act [t]o amend the procedures that apply to consideration of interstate class actions to assure fairer outcomes for class members and defendants, and for other purposes.").

completed, judges are awarding class action lawyers some \$2.5 billion in fees from the 300 or so class actions settled every year in federal court.⁶ It is not known how much money class action lawyers receive in fees from class actions settled in state court, but I have estimated that this \$2.5 billion from federal court settlements may be equivalent to 10% of the contingency fees lawyers collect in the entire American tort system every year.⁷

Although \$2.5 billion sounds like a great deal of money to award class action lawyers in only 300 or so cases, my empirical research also shows that the settlements on which these fees were based totaled some \$16 billion a year.⁸ Thus, in the aggregate, class action lawyers appear to be taking only 15% of all of the money they recover for class members in federal court. This percentage take is much lower than the typical take of contingency-fee lawyers in individual litigation.⁹

It is true that especially large settlements drive down the aggregate percentage taken by class action lawyers; the judges who set the fees awarded to class action lawyers tend to award smaller fee percentages in large settlements than in small settlements.¹⁰ Nonetheless, even when settlements are examined individually, my research has shown that, although the percentages taken by class action lawyers cover a

⁶ See Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. EMPIRICAL LEGAL STUD. (forthcoming 2010) (manuscript at 26 tbl.7), available at <http://ssrn.com/abstract=1442108> (showing class action lawyers were awarded \$2.9 billion in fees and expenses in 2006, and \$2.1 billion in 2007).

⁷ See *id.* (manuscript at 4).

⁸ See *id.* (explaining that class action settlements in 2006 and 2007 involved “over \$33 billion”).

⁹ See Lester Brickman, *ABA Regulation of Contingency Fees: Money Talks, Ethics Walks*, 65 FORDHAM L. REV. 247, 248 (1996) (noting that “standard contingency fees” are “usually thirty-three percent to forty percent of gross recoveries” (emphasis omitted)); Joni Hersch, Jeffrey O’Connell & W. Kip Viscusi, *An Empirical Assessment of Early Offer Reform for Medical Malpractice*, 36 J. LEGAL STUD. S231, S238 (2007) (referencing “the more typical one-third contingency fee rate”); F. Patrick Hubbard, *Substantive Due Process Limits on Punitive Damages Awards: “Morals Without Technique”?*, 60 FLA. L. REV. 349, 383 (2008) (mentioning “the usual 33-40 percent contingent fee” (quoting *Mathias v. Accor Econ. Lodging, Inc.*, 347 F.3d 672, 677 (7th Cir. 2003))); Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DEPAUL L. REV. 267, 286 (1998) (reporting the results of a survey of Wisconsin lawyers, which found that “[o]f the cases with a [fee calculated as a] fixed percentage [of the recovery], a contingency fee of 33% was by far the most common, accounting for 92% of those cases”).

¹⁰ See Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study*, 1 J. EMPIRICAL LEGAL STUD. 27, 35-36 (2004) (explaining that economies of scale call for lower percentage fee awards when large amounts are given to the class); Fitzpatrick, *supra* note 6 (manuscript at 31).

broad range—in recent years, from 3% to 47%—the mean and median are only about 25%.¹¹ These mean and median numbers are, again, lower than the typical take in individual litigation.

Of course, one of the justifications for class action litigation is that it offers plaintiffs the same economies of scale that defendants enjoy.¹² Accordingly, lower fee percentages in class action litigation do not necessarily mean that class action lawyers are making too little; one might hope that the economies of scale are passed on to class members in the form of lower fee percentages. On the other hand, as I explain below, one might not hope that these economies are passed on for all types of class actions, and in particular, for small-stakes actions.

Nonetheless, judges who award fees to class action lawyers do not appear to be doing so in accordance with this justification or any other normative theory. Judges usually award fees according to what is known as the percentage-of-the-recovery method, which simply asks judges to award whatever fee percentage they deem “reasonable.”¹³ In most jurisdictions, judges are asked to derive this reasonable fee using a multifactor test that is highly indeterminate.¹⁴ As a result, judges appear more or less to pluck percentages out of thin air or to replicate the percentages plucked out of thin air in previous awards.¹⁵ To my knowledge, neither judges nor commentators have offered a robust normative defense of the 25% figure around which fee awards have coalesced, let alone the broad range of fee awards above and below that figure.

In this Article, I perform a normative examination of fee percentages in class action litigation. I argue that in small-stakes class actions, lawyers are undercompensated. At least from a social-welfarist utilitarian perspective, there is no reason to pass on to class members the economies of aggregate litigation in these class actions. In order to maximize social welfare, it is often thought that litigation should both deter defendants from causing harm and insure plaintiffs against

¹¹ Fitzpatrick, *supra* note 6 (manuscript at 29, 31 tbl.8). These numbers reflect only settlements in which judges awarded fees according to the percentage-of-the-recovery method (which they used in the vast majority of cases), rather than the lodestar method.

¹² See *infra* note 74.

¹³ For a discussion of the methods judges use in awarding fees, see *infra* Part I.

¹⁴ See *infra* text accompanying notes 43-45 (explaining the various factors courts use to decide what fee percentage attorneys should receive).

¹⁵ See Samuel R. Berger, *Court Awarded Attorneys' Fees: What Is "Reasonable"?*, 126 U. PA. L. REV. 281, 284 (1977) (describing judicial fee setting “[t]o a great extent” as “depend[ing] upon ‘the roll of the dice’”); Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. 1239, 1280 (reporting that courts often “simply look to the percentage fee applied by other courts”).

those harms when defendants are not deterred. This is what I call the “deterrence-insurance” theory of civil litigation. But small-stakes class actions serve no insurance function. Rather, the only function they serve is deterrence. As a result, I assert that we should not be concerned about compensating class members in small-stakes class actions and, instead, should be concerned only with fully incentivizing class action lawyers to bring as many cost-justified actions as possible. That is, the deterrence-insurance theory of civil litigation suggests that the optimal award of fees to class action lawyers in small-stakes actions is 100% of judgments. It is for this reason that I believe class action lawyers are not only not making too much, but, rather, making too little—far too little.

In light of the cost of providing deterrence through litigation and the lack of need to provide injured parties with insurance for small-stakes harms, a utilitarian might ask whether there is a better mechanism than class action litigation to deter defendants from causing small-stakes harms—such as, perhaps, *qui tam*-like proceedings or administrative proceedings initiated by public officials. Although I am skeptical that such public-sector proceedings can match either the incentives or resources available in the private sector to bring defendants to account for their activities,¹⁶ it is beyond the scope of this Article to compare other regulatory mechanisms to litigation. Rather, in this Article, I take the regulatory system as I find it and ask how it can be optimized using the normative principles of utilitarianism. As I have already noted, in my view these principles suggest that class action lawyers should be awarded all of small-stakes settlements.

Of course, it is unlikely that judges in the current political climate, where opinion runs so strongly against class action lawyers, will feel comfortable awarding class action lawyers fees equal to 100% of settlements. Moreover, it is not entirely clear that judges have the legal authority to award fees at such a level. In many states, statutes or rules of professional responsibility cap contingency-fee percentages.¹⁷ On the other hand, few of these caps explicitly apply to class action litigation. Moreover, with respect to federal judges, there is a plausible argument that Federal Rule of Civil Procedure 23, which authorizes fed-

¹⁶ But see Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1325-49 (2008) (rejecting these virtues of the private sector in the enforcement of securities fraud laws).

¹⁷ See *infra* text accompanying notes 137-45.

eral judges to award “reasonable” fees in class actions,¹⁸ overrides any state contingency-fee caps.¹⁹ But, even if judges cannot award 100% of settlements to class action lawyers due to political or legal constraints, deterrence-insurance theory nonetheless suggests that they should award fee percentages as high as they can. By any measure, this is much more than they are awarding now.

Thus, in my view, judges ought to seek out opportunities to shift a greater portion of small-stakes settlements to class action lawyers. Beyond simply raising fee percentages, judges might consider giving to lawyers class action proceeds that, for various reasons, cannot be distributed to class members.²⁰ Many district courts currently distribute such proceeds to charities under the so-called “cy pres” doctrine.²¹ Sometimes these charities have only the most tenuous connection to the case at hand, and some district courts have received severe public criticism for their charitable decisions.²² Deterrence-insurance theory suggests that the better course might be to award leftover settlement proceeds to class counsel.

Deterrence-insurance theory can only supply so much normative guidance to judges who make fee awards, however. In contrast to small-stakes class actions, large-stakes actions may serve an insurance purpose. That is, every dollar that a court awards to class counsel rather than the class to further the deterrence goals of civil litigation may come at the expense of the insurance goals of civil litigation. As such, it is difficult to say, as a theoretical matter, how class counsel and class members should split either large-stakes class actions or “mixed” class actions in which both small- and large-stakes elements are present. On the other hand, at least in large-stakes class actions, it is arguably less imperative to supply judges with a normative theory of fee awards because it has become difficult to certify class actions when claims are individually viable.²³ Especially in the mass tort area, indi-

¹⁸ FED. R. CIV. P. 23.

¹⁹ See *infra* text accompanying notes 143-53.

²⁰ See *infra* text accompanying notes 152-63.

²¹ See *infra* notes 157-65 and accompanying text.

²² See, e.g., Editorial, *When Judges Get Generous*, WASH. POST, Dec. 17, 2007, at A20 (“[G]iving [undistributed funds] away to favorite charities with little or no relation to the underlying litigation is inappropriate and borders on distasteful.”).

²³ See, e.g., *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 748-49 (5th Cir. 1996) (decertifying a class when “individual suits [were] feasible” because “individual damage claims [were] high,” and explaining that a prospective class may have difficulty demonstrating the superiority of a class action over multiple individual suits “[i]n a case . . . where each plaintiff may receive a large award, and fee shifting is often available”); *Re-*

vidually viable claims must be prosecuted separately,²⁴ and, unlike class actions, they will be governed by fee-award contracts negotiated between plaintiffs and their lawyers. To the extent that such cases are resolved on an aggregate basis, they are usually resolved through settlements in which an inventory of individual claims is compromised simultaneously, and individual retainer contracts can still govern the fee awards in such circumstances.²⁵ At the same time, a few judges have begun to override the fees set by individual retainer contracts in these so-called “inventory settlements.”²⁶ If this trend catches on, it

cent Cases, *Castano v. American Tobacco Co.*, 110 HARV. L. REV. 977, 978 (1997) (“[W]hen individual plaintiffs stand to recover large sums . . . a class action is not needed to overcome the problem of ‘negative value’ suits, in which the small value of claims relative to litigation costs effectively prevents individual litigation.”).

²⁴ See, e.g., *In re Rhone-Poulenc Rorer, Inc.*, 51 F.3d 1293, 1304 (7th Cir. 1995) (“Most federal courts . . . refuse to permit the use of the class-action device in mass-tort cases”); *Sterling v. Velsicol Chem. Corp.*, 855 F.2d 1188, 1196-97 & n.9 (6th Cir. 1988) (citing multiple cases in which courts refused to certify mass tort accidents as class actions because of “the problem of individualization of issues”); Howard M. Erichson, *A Typology of Aggregate Settlements*, 80 NOTRE DAME L. REV. 1769, 1772 (2005) (noting that Supreme Court jurisprudence has increased “the difficulty of obtaining class certification for personal injury mass torts”); Samuel Issacharoff, *Private Claims, Aggregate Rights*, 2008 SUP. CT. REV. 183, 208 (“As a result [of *Amchem Window Products, Inc. v. Windsor*, 521 U.S. 591 (1997), and *Ortiz v. Fibreboard Corp.*, 527 U.S. 815 (1999)], class actions seemed to drop out of the available set of tools for attempting to settle most mass torts”); Barry F. McNeil & Beth L. Fancsali, *Mass Torts and Class Actions: Facing Increased Scrutiny*, 167 F.R.D. 483, 488 (1996) (“[F]ederal courts remain reluctant to certify litigation (non-settlement) classes in mass tort cases. In fact, most mass tort class certification motions are ultimately rejected.” (footnotes omitted)); David Rosenberg, *Class Actions for Mass Torts: Doing Individual Justice by Collective Means*, 62 IND. L.J. 561, 565 (1987) [hereinafter Rosenberg, *Class Actions for Mass Torts*] (“[C]lass actions have consistently received a hostile reception in mass tort cases.”); David Rosenberg, *Of End Games and Openings in Mass Tort Cases: Lessons from a Special Master*, 69 B.U. L. REV. 695, 696 (1989) (noting “the persistent judicial ‘skepticism’ that usually leads to refusals to bring or certify class actions in mass tort cases”).

²⁵ See Erichson, *supra* note 24, at 1786-92 (analyzing potential award allocations within typical circumstances, such as a lump sum paid by the defendant and divided among plaintiffs, or individual settlements negotiated by plaintiffs’ attorneys); Deborah R. Hensler, *As Time Goes By: Asbestos Litigation After Amchem and Ortiz*, 80 TEX. L. REV. 1899, 1912 (2002) (reporting that even in earlier mass tort cases, “plaintiffs’ attorneys had learned that the most effective strategy for prosecuting claims against asbestos corporations was to identify large numbers of asbestos-exposed workers . . . , enter into contingency fee contracts to represent each of these workers individually, and negotiate large-scale settlements of hundreds (or thousands) of these claims at a time”); Issacharoff, *supra* note 24, at 209 (mentioning “private aggregations of claims portfolios through the plaintiffs’ bar” as the most common alternative to disfavored class settlements in mass tort cases).

²⁶ See *In re Vioxx Prods. Liab. Litig.*, 574 F. Supp. 2d 606, 617 (E.D. La. 2008) (“The attorneys have benefitted from a uniform and highly efficient resolution procedure; the claimants should similarly benefit from fees reduced”); *In re Guidant*

may become more imperative to supply judges with a normative theory of fee awards even in large-stakes class actions.

In Part I of this Article, I report the judiciary's current approach to awarding fees in class actions. I explain that judges have been given broad discretion over how much class action lawyers receive from class action judgments, that judges appear to apply this discretion in the absence of any normative theory, and that class action lawyers end up taking smaller fractions of judgments than do their individual-litigation counterparts. In Part II, I take a normative look at fee awards in class actions. I argue that in small-stakes class actions, the fractions class action lawyers are currently receiving are too low. Indeed, I argue that, as a theoretical matter, it is hard to see why class action lawyers in these cases should not be awarded all of the settlements as their fees. Although, as I note in Part III, this may be politically and perhaps even legally infeasible, deterrence-insurance theory nonetheless instructs judges to award as much as they can to class action lawyers in these cases. In addition to raising fee percentages to the maximum levels politically and legally feasible, I suggest that judges might seek out other opportunities to increase the take that class counsel receive in these cases, such as the leftover class action proceeds that are now (controversially) sent to charities.

I. FEE AWARDS IN CLASS ACTION LITIGATION: WHAT JUDGES DO

Class actions are litigated on behalf of parties in absentia. In light of this, judges have been given a great deal of power over the lawyer who litigates on behalf of the class, including how that lawyer is compensated. Like most of their state counterparts,²⁷ the Federal Rules of Civil Procedure call for district court judges to select class counsel,²⁸

Corp. Implantable Defibrillators Prods. Liab. Litig., No. 05-1708, 2008 WL 3896006, at *8-10 (D. Minn. Aug. 21, 2008) (generating multivariable equations to calculate fee awards); *In re Guidant Corp. Implantable Defibrillators Prods. Liab. Litig.*, No. 05-1708, 2008 WL 682174, at *18-20 (D. Minn. Mar. 7, 2008) (capping legal fees to avoid "excessive" fee awards for attorneys who, by representing many plaintiffs, benefited from economies of scale achieved through coordinated discovery), *amended in part by In re Guidant Corp.*, 2008 WL 3896006; *In re Zyprexa Prods. Liab. Litig.*, 424 F. Supp. 2d 488, 490-91 (E.D.N.Y. 2006) (capping legal fees at 20-37.5% of recovery, depending upon each plaintiff's recovery level and injury and taking "unique circumstances" into account).

²⁷ See, e.g., Charles Silver, *Due Process and the Lodestar Method: You Can't Get There from Here*, 74 TUL. L. REV. 1809, 1811 (2000) (noting that "[m]ost states' class action rules[] [are] patterned after Federal Rule 23").

²⁸ See FED. R. CIV. P. 23(g)(1) ("Unless a statute provides otherwise, a court that certifies a class must appoint class counsel.").

and, if the litigation produces a judgment or a settlement for the class, the Rules give district court judges discretion to award class counsel a “reasonable” fee award for their efforts.²⁹ In most cases, these fee awards come from proceeds that would otherwise go to class members. These cases are often called “common fund” cases, and class counsel are compensated from the fund on the theory that it would be unjust to enrich the class without also rewarding the counsel that created the class’s enrichment.³⁰ In cases where the litigation is based on a fee-shifting statute, the fee awards come from defendants and do not reduce the proceeds collected by class members.³¹

At the outset of the modern class action era, which began with amendments to the Federal Rules in 1966,³² judges exercised their discretion to award fees by using the familiar lodestar method in both common-fund and fee-shifting cases.³³ Under this method, class counsel were awarded fees equal to the number of hours they worked on the case (to the extent the hours were reasonable), multiplied by a reasonable hourly rate as well as by a discretionary multiplier that could reward class counsel for the risk of nonrecovery.³⁴ In the 1980s, however, this method was criticized because it did not align the interests of class counsel with the interests of the class.³⁵ Under the lodestar method, class counsel’s compensation increased the longer the lit-

²⁹ See *id.* 23(h) (“In a certified class action, the court may award reasonable attorney’s fees . . .”).

³⁰ See Charles Silver, *A Restitutionary Theory of Attorneys’ Fees in Class Actions*, 76 CORNELL L. REV. 656, 657 (1991) (suggesting that “attorneys are entitled to be paid because class members are enriched at the attorneys’ expense”).

³¹ This is true at least as a technical matter. When class actions settle, as virtually all that are not dismissed do, defendants presumably negotiate the settlement amount for the class with an eye toward their likely liability for fees. See, e.g., *Weinberger v. Great N. Nekosa Corp.*, 925 F.2d 518, 524 (1st Cir. 1991) (noting the “danger” in fee-shifting cases that “the lawyers might urge a class settlement at a low figure . . . in exchange for red-carpet treatment on fees”).

³² See 7A CHARLES ALAN WRIGHT ET AL., *FEDERAL PRACTICE AND PROCEDURE* § 1753 (3d ed. 2005) (describing the changes made by the 1966 revisions to Rule 23).

³³ See, e.g., Sandra R. McCandless et al., Tort Trial & Ins. Practice Section of the Am. Bar Ass’n, *Report on Contingent Fees in Class Action Litigation*, 25 REV. LITIG. 459, 467-69 (2006) (detailing the history and development of the lodestar approach).

³⁴ See Eisenberg & Miller, *supra* note 10, at 31.

³⁵ See, e.g., McCandless et al., *supra* note 33, at 468-69 (noting criticisms of the lodestar method and stating that the “percentage method became resurgent particularly in the mid 1980s because of the 1985 Third Circuit Report criticizing the lodestar method”); see also John C. Coffee, Jr., *Understanding the Plaintiff’s Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 691 (1986) (explaining that the lodestar method can lead to “collision” between the plaintiffs’ attorney and defendants).

igation wore on; class members, by contrast, prefer cases to end as quickly as possible so they can receive their compensation as quickly as possible.³⁶ Moreover, class counsel were compensated irrespective of how much they recovered for the class; class members, by contrast, prefer to receive as much as possible.³⁷ To better align the interests of class counsel and the class, judges began compensating class counsel by awarding them a percentage of the class's recovery.³⁸ This way, the more the class recovers, the more class counsel are paid, and class counsel have no incentive to drag cases on unnecessarily.³⁹ The percentage-of-the-recovery method has now become the dominant method for awarding fees in class action cases. According to my research, federal district courts used the percentage method to award attorneys' fees in nearly 70% of class action judgments in 2006 and 2007.⁴⁰ By contrast, judges used the lodestar method only 12% of the time, and mostly in cases where the primary, if not the only, form of relief was injunctive.⁴¹ Because injunctive class actions present some-

³⁶ See *In re Activision Sec. Litig.*, 723 F. Supp. 1373, 1378 (N.D. Cal. 1989) (stating that the lodestar method "encourages abuses such as unjustified work and protracting the litigation" and "conclud[ing] that in class action common fund cases the better practice is to set a percentage fee"); Coffee, *supra* note 35, at 718 (mentioning the "obvious incentive for delay under the lodestar formula, which would not arise under a percentage of the recovery formula"); McCandless et al., *supra* note 33, at 468 ("By using the number of hours worked as a starting point for calculating the fee, the lodestar method encourages lawyers to ensure that the number of hours in the case is high.").

³⁷ See Coffee, *supra* note 35, at 691 ("By severing the fee award from the settlement's size, [the lodestar] formula facilitates the ability of defendants and the plaintiff's attorneys to arrange collusive settlements that exchange a low recovery for a high fee award.").

³⁸ See, e.g., *In re Xcel Energy, Inc., Sec., Derivative & "ERISA" Litig.*, 364 F. Supp. 2d 980, 992 (D. Minn. 2005) ("[O]ne of the primary advantages of the [percentage of recovery] method is that it is thought to equate the interests of class counsel with those of the class members and encourage class counsel to prosecute the case in an efficient manner." (quoting *Lachance v. Harrington*, 965 F. Supp. 630, 647 (E.D. Pa. 1997) (alteration in original))); *In re Activision*, 723 F. Supp. at 1378 (determining that class counsel should receive 30% of the recovery "absent extraordinary circumstances"); John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 887 (1987) ("[E]ven uninformed clients can align their attorney's interests with their own by compensating them through a percentage-of-recovery fee formula."); Coffee, *supra* note 35, at 718 (mentioning the "obvious incentive for delay under the lodestar formula, which would not arise under a percentage of the recovery formula").

³⁹ See sources cited *supra* note 38 (discussing the benefits of the percentage-of-the-recovery method).

⁴⁰ See Fitzpatrick, *supra* note 6 (manuscript at 26-28).

⁴¹ See *id.* (manuscript at 27). It was unclear in the remaining cases which method the district court used to award fees. It is not entirely clear whether the percentage method is as predominant in state court as it is in federal court; it apparently was not

thing of a special case when it comes to fee-award decisions,⁴² I focus the remainder of this Article on damages class actions.

Although judges relied on what was essentially normative economic theory in switching from the lodestar to the percentage method in awarding fees, they do not appear to rely on normative theory in deciding *what* percentage to award class counsel under this method. Instead, courts typically use an indeterminate multifactor test—often with the lodestar as one of the factors—to select a “reasonable” fee percentage.⁴³ For example, the Eleventh Circuit has identified a *non-exclusive* list of fifteen factors that district courts should consider when deciding what fee percentage is reasonable:

(1) the time and labor required; (2) the novelty and difficulty of the questions involved; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the “undesirability” of the case; (11) the nature and the length of the professional relationship with the client; [and] (12) awards in similar cases;⁴⁴

as well as “[13)] whether there are any substantial objections by class members or other parties to the settlement terms or the fees required by counsel[;] [(14)] any non-monetary benefits conferred upon the

as predominant over a decade ago. See Geoffrey P. Miller & Lori S. Singer, *Nonpecuniary Class Action Settlements*, 60 LAW & CONTEMP. PROBS., Autumn 1997, at 97, 143 (“Some states have joined the federal trend toward the percentage method However, other states have gone in the opposite direction.”).

⁴² Cf. Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs’ Attorney’s Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 116 (1991) (noting that their reverse-auction proposal, in which the right to pursue class action claims would be auctioned, “would face difficulties in . . . cases in which injunctive relief is the primary relief sought”).

⁴³ See, e.g., *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 195 n.1 (3d Cir. 2000) (naming seven factors); *Goldberger v. Integrated Res. Inc.*, 209 F.3d 43, 50 (2d Cir. 2000) (six factors); *Brown v. Phillips Petroleum Co.*, 838 F.2d 451, 454-55 (10th Cir. 1988) (twelve factors); *Zilhaber v. UnitedHealth Group, Inc.*, 646 F. Supp. 2d 1075, 1082 (D. Minn. 2009) (twelve factors); *In re Tyco Int’l, Ltd. Multidist. Litig.*, 535 F. Supp. 2d 249, 266 (D.N.H. 2007) (five factors); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 461 F. Supp. 2d 383, 385 (D. Md. 2006) (applying twelve factors developed by other courts and adding one more); *In re Baan Co. Sec. Litig.*, 288 F. Supp. 2d 14, 17 (D.D.C. 2003) (seven factors).

⁴⁴ *Camden I Condo. Ass’n, Inc. v. Dunkle*, 946 F.2d 768, 772 n.3 (11th Cir. 1991) (citing *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir. 1974)).

class by the settlement[;] and [(15)] the economics involved in prosecuting a class action.”⁴⁵

These multifactor tests ask district courts to balance considerations that cannot be quantified on the same scale.⁴⁶ Thus, many commentators believe that district courts have no choice but to award percentages based on little more than intuition⁴⁷ or to replicate the percentages awarded by other courts,⁴⁸ which, of course, were probably based on intuition as well.⁴⁹ Thus, although many courts have been attracted to 25% as the percentage to award class counsel—this was both the mean and median award by federal judges in 2006 and 2007,⁵⁰ and it serves as the presumptive award in at least one circuit⁵¹—courts and even commentators have made little attempt to justify the 25% figure from a normative or theoretical perspective.⁵²

⁴⁵ *Id.* at 775.

⁴⁶ *Cf.* Bendix Autolite Corp. v. Midwesco Enters., Inc., 486 U.S. 888, 897 (1988) (Scalia, J., concurring) (remarking that balancing tests are often “like judging whether a particular line is longer than a particular rock is heavy”).

⁴⁷ *See, e.g.,* Berger, *supra* note 15, at 284 (explaining that many district courts award fees “with little or no analysis”); Jonathan R. Macey & Geoffrey P. Miller, *Judicial Review of Class Action Settlements*, 1 J. LEGAL ANALYSIS 167, 174 (2009) (“[F]actor tests are problematic. Offering confusion as well as enlightenment, they sometimes appear to do little more than create a regime of untrammelled discretion: ‘the capacity to exercise official power as one chooses, by reference to such considerations as one wants to consider, weighted as one wants to weight them.’” (quoting Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 960 (1995))).

⁴⁸ *See, e.g.,* Thompson v. Connick, 553 F.3d 836, 867-68 (5th Cir. 2008) (approving a lower court award based on awards in other cases), *vacated*, 578 F.3d 293 (5th Cir. 2009) (en banc), *cert. granted*, 78 U.S.L.W. 3302 (U.S. Mar. 22, 2010) (No. 09-0571); *Gunter*, 223 F.3d at 195 n.1 (instructing lower courts to look to awards in other cases to set fees in class actions); *Spell v. McDaniel*, 824 F.2d 1380, 1401-03 (4th Cir. 1987) (approving a lower court award); *Casey*, *supra* note 15, at 1280 (explaining that courts often duplicate the percentage fees awarded in similar cases).

⁴⁹ *See, e.g.,* McCandless et al., *supra* note 33, at 487 (“Using a percentage that another court arrived at, without the assistance of a market, is . . . just repeating whatever mistakes the other court may have made.”).

⁵⁰ *See* Fitzpatrick, *supra* note 6 (manuscript at 4).

⁵¹ *See* Staton v. Boeing Co., 327 F.3d 938, 968 (9th Cir. 2003) (“[T]his circuit has established 25% of the common fund as a benchmark award for attorney fees.” (quoting *Hanlon v. Chrysler Corp.*, 150 F.3d 1011, 1029 (9th Cir. 1998))).

⁵² *See, e.g.,* Goldberger v. Integrated Res., Inc., 209 F.3d 43, 51 (2d Cir. 2000) (“[D]istrict courts across the nation have apparently eased into a practice of ‘systematically’ awarding fees in the 25% range, regardless of type of case, benefits to the class, numbers of hours billed, size of fund, size of plaintiff class, or any other relevant factor.” (internal quotation marks and citation omitted)); *id.* at 52 (describing the use of benchmark awards as “an all too tempting substitute for the searching assessment that should properly be performed in each case”).

Only scant more attention has been paid to the broad range of fees awarded around the 25% figure; in federal court in 2006 and 2007, this range varied from 3% to 47% of the settlement.⁵³ Some analysis of this range can be found in my research and other empirical studies which show that the factor with the most influence on the fees judges award is the size of the underlying class action settlement: judges award smaller percentages when class action settlements are larger.⁵⁴ Thus, although the typical award in class action cases is 25%, in the aggregate, class action lawyers take only 15% of the settlements they win for class members.⁵⁵ One might defend this inverse relationship between fee percentage and judgment size as a normative matter on the ground that the costs of litigating class actions do not scale up at the same rate as the size of settlements. Therefore, it is unnecessary to award class counsel the same percentages to induce them to bring such cases.⁵⁶ However, for the reasons I advance in the next Part, I think this justification is less compelling in small-stakes class actions, which make up many, if not most, of the class action cases in state and federal court. Moreover, even if this inverse relationship could be justified as a normative matter, it still does not tell courts where along the spectrum of percentages they should stop. That is, even if it is true that courts should invariably award smaller percentages in bigger cases, unless they know the baseline percentages to award in small or big cases, telling them to award more or less does not tell them very much at all. It is for all these reasons that I do not believe it is much of an exaggeration to say that district courts have been choosing class

⁵³ See Fitzpatrick, *supra* note 6 (manuscript at 29).

⁵⁴ See Eisenberg & Miller, *supra* note 10, at 54 (“As client recovery increases, the fee percent decreases.”); Fitzpatrick, *supra* note 6 (manuscript at 4) (“[F]ee percentages are strongly and inversely associated with the size of the settlement.”).

⁵⁵ See Fitzpatrick, *supra* note 6 (manuscript at 4).

⁵⁶ See Eisenberg & Miller, *supra* note 10, at 64 (“This scale effect—fee percent decreases as client recovery increases—provides empirical support for the normative justification underlying class actions. By aggregating smaller claims into a single larger action, economies of scale in legal services are achieved, which can be passed onto class members in the form of enhanced recoveries.”); Theodore Eisenberg & Geoffrey P. Miller, *Attorneys’ Fees and Expenses in Class Action Settlements: 1993–2008*, 7 J. EMPIRICAL L. STUD. (forthcoming 2010) (manuscript at 16), available at <http://ssrn.com/abstract=1497224> (“Plaintiffs’ ability to aggregate into classes that reduce the percentage of recovery devoted to fees should be a hallmark of a well-functioning class action system.”). *But see* Coffee, *supra* note 35, at 697 (arguing that courts should “award the plaintiff’s attorney a marginally greater percentage of each defined increment of the recovery” to prevent premature settlement).

action fee percentages arbitrarily, or replicating the arbitrary awards chosen by previous courts.⁵⁷

All of this is a bit surprising because the portion of class action settlements judges give to class action lawyers is a matter of great public importance. In federal court alone, judges award some \$2.5 billion in fees in only 300 or so class action settlements every year.⁵⁸ These 300 or so class action fee awards may be equivalent to 10% of the annual contingency fees collected by lawyers in the entire American tort system.⁵⁹ If the total awards in state courts were known, they would push these numbers even higher. Given that contingency fees are the engine that drives much, if not most, of the noncriminal regulation in America,⁶⁰ it is not only surprising that judges award fees in the absence of normative theory, but it is also poor public policy.

II. FEE AWARDS IN CLASS ACTION LITIGATION: WHAT JUDGES SHOULD DO

As I explained in the last Part, judges currently award a great deal of money to class action lawyers and do so largely in the absence of any normative theory. In this Part, I argue that from the normative vantage point of utilitarianism, judges are probably still awarding class action lawyers too little.

The utilitarian account of civil litigation can be captured by what I call “deterrence-insurance” theory. This theory posits that our system of civil litigation should be designed to optimally deter defendants from harming others and to optimally insure injured parties when defendants are not deterred. Although the deterrence-insurance theory is explicitly utilitarian, it also reflects much of the current scholarship

⁵⁷ See sources cited *supra* note 15. A similar assessment has been made of the way in which courts determine whether punitive damages are excessive. See Joni Hersch & W. Kip Viscusi, *Punitive Damages by Numbers: Exxon Shipping Co. v. Baker 2* (Vanderbilt Univ. Law Sch. Law & Econ., Working Paper No. 09-04, 2009), available at <http://ssrn.com/abstract=1327045> (“The rationale for setting any specific value or range of values for the relationship between punitive awards and compensatory awards follows a rather baffling circular reasoning in that it questions the soundness of current punitive damages awards while at the same time using statistics drawn from these awards to set guidelines for future punitive damages awards.”).

⁵⁸ See *supra* note 6.

⁵⁹ See *supra* note 7 and accompanying text.

⁶⁰ See, e.g., STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 277-86 (1987) (comparing and contrasting ex ante versus ex post, and privately initiated versus state-initiated, approaches to risk regulation); Samuel Issacharoff, *Regulating After the Fact*, 56 DEPAUL L. REV. 375, 377 (2007) (“What really sets the United States apart is the fact that its basic regulatory model is ex post rather than ex ante . . .”).

on litigation theory,⁶¹ and, indeed, it is consistent with the same sort of largely economic rationales that led courts and commentators to favor the percentage-of-the-recovery method of awarding fees over the lodestar method in the first place.⁶²

As I explain, the optimal solution to the fee-award problem from the deterrence-insurance perspective may well be an insightful proposal Jonathan Macey and Geoffrey Miller made several years ago: reverse auctions to choose counsel for the class.⁶³ Unfortunately, courts have widely rejected the reverse-auction proposal for a variety of practical reasons.⁶⁴ Although other scholars have stepped into some of the normative gaps left by the rejection of the Macey-Miller proposal—most notably, perhaps, Myriam Gilles and Gary Friedman, who have criticized courts for using the so-called “lodestar cross-check” in setting fee percentages in small-stakes class actions⁶⁵—it is still an open question whether deterrence-insurance theory can provide any general guidance to courts in awarding fees.

I believe deterrence-insurance theory can provide such guidance with respect to what may be the most common type of class action: small-stakes class actions, or class actions in which each class member has a very small stake in the action. In such class actions, deterrence-insurance theory suggests that the current fee-award practice among judges does not compensate class counsel adequately. Indeed, it is hard to see why, as a theoretical matter, fee awards in such cases should not be 100% of the class judgment. Of course, as I discuss in Part III, whether judges have the political or legal freedom to award fees at that level is another matter. But even if judges cannot award 100% of class judgments to class counsel, deterrence-insurance theory nonetheless suggests that they ought to award as much as they can—which, by any measure, is more than they are awarding now.

A. *The Deterrence-Insurance Theory of Civil Litigation*

To derive a theory of awarding fees in class action litigation, one must begin with a theory of class action litigation, or, more broadly, a theory of civil litigation. There are many possible theoretical justifica-

⁶¹ See *infra* note 67 and accompanying text.

⁶² See *supra* note 38 and accompanying text.

⁶³ Macey & Miller, *supra* note 42, at 105.

⁶⁴ See *infra* text accompanying notes 96-99.

⁶⁵ See Myriam Gilles & Gary B. Friedman, *Exploding the Class Action Agency Costs Myth: The Social Utility of Entrepreneurial Lawyers*, 155 U. PA. L. REV. 103, 139-46 (2006) (arguing against lodestar cross-checks because they do not optimally deter).

tions for our system of civil litigation, but in this Article, I start from the social-welfarist utilitarian premise that civil litigation should serve the dual purposes of deterring people from injuring others when the costs of doing so outweigh the benefits, and providing insurance to those who are injured when defendants are not (and should not be) deterred.⁶⁶ Deterrence-insurance theory captures much of the contemporary scholarship on litigation theory,⁶⁷ and it is consistent with the largely economic rationales upon which judges and commentators have relied in coming to favor the percentage-of-the-recovery method over the lodestar method in the first place.⁶⁸ Of course, if one selects different normative premises from which to proceed, the answer to the question of how class counsel and class members should split judgments might be different.

The utilitarian account of the deterrence function of litigation is a familiar one: it is desirable to force those who cause harms to pay an amount of damages that will optimally deter them from causing the harms to begin with.⁶⁹ That is, if we make tortfeasors or contract breachers pay for the harms they cause, then they will commit torts or breach contracts only when the benefits of doing so outweigh the costs.⁷⁰ Inducing activities whose social benefits outweigh their social costs and preventing activities whose social costs outweigh their social benefits enhances social welfare.⁷¹

⁶⁶ See David Rosenberg, *Decoupling Deterrence and Compensation Functions in Mass Tort Class Actions for Future Loss*, 88 VA. L. REV. 1871, 1879-82 (2002) (articulating the theory that tort litigation should provide "optimal deterrence" and "insurance").

⁶⁷ See Goutam U. Jois, *The Cy Pres Problem and the Role of Damages in Tort Law*, 16 VA. J. SOC. POL'Y & L. 258, 276-77 (2008) ("This approach has much in common with the law and economics approach [and] concludes that deterrence and insurance are the primary functions of tort law and tort damages."); Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 566 (noting that deterrence-insurance theory follows from "the utilitarian objective of maximizing welfare by deterring socially inappropriate risk-taking").

⁶⁸ See sources cited *supra* note 36.

⁶⁹ See Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 573 ("The prevailing utilitarian justification for tort liability is to create optimal incentives for accident avoidance."); David Rosenberg, *Individual Justice and Collectivizing Risk-Based Claims in Mass-Exposure Cases*, 71 N.Y.U. L. REV. 210, 233 (1996) ("[T]he deterrence aim . . . seeks to induce potential business defendants to limit their risk taking to economically efficient levels . . .").

⁷⁰ See Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 573 (discussing the impact of maximizing optimal care).

⁷¹ See, e.g., Peter Linzer, *On the Amoralty of Contract Remedies—Efficiency, Equity, and the Second Restatement*, 81 COLUM. L. REV. 111, 114 (1981) ("[E]fficiency theory suggests that promisors who breach increase society's welfare if their benefit exceeds the losses of their promisees."); Richard A. Posner, *Let Us Never Blame a Contract Breaker*, 107 MICH. L. REV. 1349, 1351 (2009) ("If A breaks his contract with B to sell to C because C

It is equally familiar how the class action device furthers this deterrence function of civil litigation. When claims are too small to pursue individually, aggregating them into a class action that becomes worthwhile to pursue permits suits to go forward that would not have done so without the device.⁷² This, of course, forces defendants to internalize more of the costs of their activities, thereby pushing deterrence closer to the optimal level.⁷³ But even when claims are worth enough that plaintiffs would have brought them in the absence of the class action device, aggregating the claims furthers the deterrence purpose of civil litigation by permitting plaintiffs to reap the same economies of scale as defendants.⁷⁴ These economies not only decrease the administrative costs of deterring through civil litigation, but they permit the plaintiff side to match the investments in class action litigation made by the defendant side; it is thought that this leveling of the playing field increases the likelihood that the judgments in such cases will reflect the actual legal harms defendants cause.⁷⁵

will pay more than the harm (which equals damages) to *B* from the breach, the breach increases the social product: *B* is no worse off, and *A* and *C* are both better off.”).

⁷² See Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 564 (“Because defendant firms are in a position to spread the litigation costs over the entire class of mass accident claims, while plaintiffs, being deprived of the economies of scale afforded by class actions, can not, the result will usually be that the firms will escape the full loss they have caused . . .”).

⁷³ See, e.g., A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 878 (1998) (“[I]f a defendant will definitely be found liable for the harm for which he is responsible, the proper magnitude of damages is equal to the harm the defendant has caused.”).

⁷⁴ See Bruce Hay & David Rosenberg, “*Sweetheart*” and “*Blackmail*” Settlements in Class Actions: Reality and Remedy, 75 NOTRE DAME L. REV. 1377, 1380-81 (2000) (“The potential virtue of a class action is that it [levels the playing field]. Once the plaintiffs’ claims are aggregated . . . the plaintiffs can exploit the same scale economies as the defendant This puts the plaintiffs in a position of parity with the defendant, who will exploit scale economies whether or not the case is brought as a class action.”); Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 573 (stating that mandatory class actions would “substantially diminish the cost advantage conferred on defendant firms by the private law, disaggregative process”); see also David Rosenberg, *The Causal Connection in Mass Exposure Cases: A “Public Law” Vision of the Tort System*, 97 HARV. L. REV. 849, 902 (1984) (“[T]he case-by-case method . . . affects plaintiff attorneys and defendants unequally. Defendants can generally exploit . . . many of the economies of scale afforded by aggregative procedure. In contrast, plaintiff attorneys must bear the brunt of the inefficiencies of the case-by-case process.”); David L. Shapiro, *Class Actions: The Class as Party and Client*, 73 NOTRE DAME L. REV. 913, 918 (1998) (“[T]he various joinder devices, including the class action, [can be seen] as essentially techniques for allowing individuals to achieve the benefits of pooling resources against a common adversary.”).

⁷⁵ See Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 573 (arguing that class action procedures promote tort liability’s “social welfare maximizing function”).

It should be noted that the deterrence function of civil litigation only tells us how much those who cause injuries should pay; it does not tell us to whom they should make those payments. Indeed, a purely deterrence-based theory of civil litigation might be indifferent between defendants paying those they have injured and defendants paying completely unrelated third parties, such as governmental entities. Nonutilitarian litigation scholars often use moral theories of fault and compensation to justify ordering defendants to pay the persons they injured.⁷⁶ But there is also a utilitarian justification for asking defendants to pay the persons they injured rather than third parties: doing so enhances social welfare by insuring individuals against injury. As David Rosenberg has explained,

[T]he risk-averse individual would be willing to purchase insurance against loss from the residual, reasonable risk that optimal deterrence cannot prevent. Because risk-averse individuals derive diminishing marginal utility from money, they will rationally agree to pay certain insurance premiums to obtain full compensation for accident losses they might suffer at some future time.⁷⁷

Plaintiffs pay “premiums” for the insurance that civil litigation provides in the form of higher prices for products they purchase from defendants that have been forced to internalize the costs of litigation judgments.⁷⁸ Indeed, failing to insure risk-averse individuals has negative social consequences in addition to negative consequences for the risk-averse individuals themselves. When risk-averse individuals are forced to go uninsured, they may change their primary behavior in a manner that is inefficient: they may, for example, take too much precaution to avoid injuries, or they may avoid certain activities altogether even though those activities are the highest uses of their time.⁷⁹ In

⁷⁶ See, e.g., John C.P. Goldberg, *Twentieth-Century Tort Theory*, 91 GEO. L.J. 513, 521-37 (2003).

⁷⁷ Rosenberg, *supra* note 66, at 1881-82.

⁷⁸ See PAUL H. RUBIN, *TORT REFORM BY CONTRACT* 42 (1993) (“[D]amage payments . . . have many of the characteristics of insurance. It is insurance that is bundled with the product.”); Rosenberg, *Class Actions for Mass Torts*, *supra* note 24, at 591 (“The defendant obtains the policy and surcharges consumer-potential victims for the premium.”).

⁷⁹ See Robert Heidt, *The Avid Sportsman and the Scope for Self-Protection: When Exculpatory Clauses Should Be Enforced*, 38 U. RICH. L. REV. 381, 420 (2004) (“The lack of liability insurance for an activity will lead vendors who feel they must carry liability insurance to abandon even high demand and relatively safe activities. In other words, the patrons’ demand for an activity may be great enough to enable the vendor to offer the activity profitably at the activity’s full cost but yet be insufficient to overcome the unwillingness of the vendor to go without liability insurance. As a result, socially desirable recreational activities can disappear for insurance rather than deterrence reasons.”);

short, by forcing defendants to pay plaintiffs, civil litigation simultaneously enhances social welfare both by deterring benefit-unjustified harms and by providing insurance when harms are benefit justified or otherwise undeterred.

Again, the class action device furthers this insurance function of civil litigation. To the extent the device permits the plaintiff side of litigation to reap the same economies of scale as defendants, and those economies are passed on to class members in the form of lower attorneys' fees, plaintiffs can keep more of their judgments for themselves. This brings their ultimate recoveries closer to the cost of their injuries, making the insurance civil litigation provides more complete.⁸⁰ Moreover, to the extent that the device permits actions to go forward that might not have done so individually, it will provide insurance to plaintiffs in more of the instances in which they are injured.

It is important to note that the question at the heart of this Article—how judgments should be split between attorneys and plaintiffs—is different from many of the design questions that arise in our system of civil litigation. The question of attorney compensation pits the deterrence function of litigation against the insurance function. Consider, by contrast, the question of how much defendants should pay plaintiffs in damages. With the exception of questions such as whether defendants should pay for nonpecuniary harms like pain and suffering (it is thought that rational consumers would not want to pay premiums in the form of higher product prices to insure against those harms),⁸¹ both optimal deterrence⁸² and optimal insurance⁸³ are usually achieved when defendants pay damages equal to the cost of the in-

Jois, *supra* note 67, at 280 (“[U]ncertainty and the link between harm and compensation serve to distort consumption and production incentives.”).

⁸⁰ See Rosenberg, *supra* note 66, at 1882 (“Full coverage is optimal because it represents the point at which further investment in premiums yields negative marginal net benefits. . . . [F]ull insurance coverage equalizes the individual’s marginal utility from wealth between the accident and no-accident states and thus increases expected utility. The individual effectively employs insurance to transfer wealth from the no-accident state to the accident state up to the point at which an additional dollar of wealth yields the same marginal utility in either state. Beyond that point, the individual would follow the reverse course.”).

⁸¹ See, e.g., Rosenberg, *supra* note 69, at 226-27 (“That most consumers of insurance would rationally reject coverage for mental distress is confirmed by the fact that such coverage is virtually nowhere to be found on the private insurance market or in any state or federal program for workers’ compensation or social insurance.”).

⁸² See, e.g., Polinsky & Shavell, *supra* note 73, at 878 (“[I]f a defendant will definitely be found liable for the harm for which he is responsible, the proper magnitude of damages is equal to the harm the defendant has caused.”).

⁸³ See Rosenberg, *supra* note 66, at 1882 (“Full [insurance] coverage is optimal . . .”).

juries they have caused plaintiffs. That is, the deterrence and insurance purposes of litigation often point to the same answer for many of the damages questions of litigation design.

But this is not the case with respect to attorney compensation. Because attorneys often finance litigation—and, in class actions, they virtually always do—every additional dollar given to plaintiffs instead of their attorneys will decrease the level of deterrence even further from the optimum. Lower compensation to attorneys means they will bring fewer cost-justified actions. For example, suppose the expected value of a lawsuit is \$1,000,000. If it would cost any attorney \$350,000 to litigate the action, no attorney would go forward with the case if she stood to take only 33% of the judgment instead of, say, 40%. This would leave \$1,000,000 in harm caused by the defendant uninternalized and, therefore, undeterred.⁸⁴ On the other hand, every additional dollar given to attorneys instead of plaintiffs will decrease the level of insurance even further from the optimum, because plaintiffs will receive an amount even further from full compensation. That is, when it comes to the question of how to split judgments between plaintiffs and their attorneys, the deterrence and insurance functions of litigation work at cross purposes.

In individual litigation, of course, we leave the decision of how to split awards largely to plaintiffs and lawyers themselves. A plaintiff can negotiate fees with lawyers in a competitive marketplace and find the lawyer willing to take her case at the lowest price. But for the price caps that rules of professional responsibility and the occasional statute place on contingency fees, relying on the marketplace in this way should, in theory, permit every cost-justified suit to go forward (thereby maximizing deterrence) with the smallest possible cut taken by the lawyer (thereby maximizing insurance).⁸⁵

In contrast, we cannot rely on plaintiffs negotiating in a marketplace in class action litigation because the plaintiffs in class actions are in absentia.⁸⁶ This is why courts are charged with deciding how to split

⁸⁴ For a similar example, see Macey & Miller, *supra* note 42, at 60-61.

⁸⁵ See, e.g., Rudy Santore & Alan D. Viard, *Legal Fee Restrictions, Moral Hazard, and Attorney Rents*, 44 J.L. & ECON. 549, 549 (2001) (“[I]t is well known that competition among attorneys handling personal injury lawsuits produces a fee structure that is efficient and that yields zero economic profits.”).

⁸⁶ See Eisenberg & Miller, *supra* note 56 (manuscript at 2) (noting that negotiation of attorneys’ fees between attorneys and clients “does not work in the case of class action and derivative litigation: in these contexts there is no client capable of negotiating with the attorney”).

class action judgments between lawyers and plaintiffs.⁸⁷ The question in class actions is how best to balance the deterrence and insurance functions of litigation when setting these fee awards. As I explain in the next Section, neither commentators nor courts have thus far answered this question adequately.

B. Deterrence-Insurance Theory and the Prior Proposals and Practices by Commentators and Courts

One possible method of deciding how to split class action judgments between class members and class counsel is simply to borrow the split the market produces in individual litigation. Indeed, although the mean and median fee awards in federal court are 25%, there are many awards at the 33% level,⁸⁸ which, again, is a common fee percentage negotiated in the market for individual litigation.⁸⁹ There is little reason, however, to think that the split in the market for individual litigation maximizes deterrence and insurance in aggregate litigation. For one thing, as I noted above, aggregate litigation permits plaintiffs to reap the benefits of economies of scale in litigation, and, in a competitive marketplace, one might expect those economies to be passed on to clients in the form of lower attorneys' fees.⁹⁰ In addition, many class actions aggregate claims that are too small to bring individually; there is therefore no individual market from which to borrow fee percentages. Indeed, as I explain in Section II.C, I think that plaintiffs in small-stakes cases should be willing to give their attorneys fee awards much larger than 33%.⁹¹

The most comprehensive attempt to provide normative guidance to judges in class actions that is consistent with deterrence-insurance theory is Jonathan Macey and Geoffrey Miller's proposal to use reverse auctions to set fee percentages.⁹² Under this proposal, district court judges would receive bids from lawyers interested in being appointed

⁸⁷ See *id.* ("In [class actions], therefore, the court must independently determine the appropriate attorneys' fee award.").

⁸⁸ See Fitzpatrick, *supra* note 6 (manuscript at 30 fig.4) (illustrating that many fee awards were at 33% in 2006 and 2007).

⁸⁹ See *supra* note 9 and accompanying text (reporting average contingency fee rates received by lawyers in individual litigation).

⁹⁰ See *supra* note 74 and accompanying text.

⁹¹ See *infra* notes 118-23 and accompanying text (explaining that higher fees would benefit society by increasing the deterrent effects of small-claim class actions).

⁹² See Macey & Miller, *supra* note 42, at 112-13 ("[T]he existence of an auction mechanism might stimulate the development of more effective means for obtaining public financing.").

class counsel at the outset of the litigation, and the lawyers who were willing to accept the lowest fee percentage would win the representation.⁹³ This approach has considerable merit from the perspective of deterrence-insurance theory because it creates a marketplace for class representation that, much like the marketplace for individual litigation, should permit every cost-justified class action to go forward at the lowest possible price to class members.⁹⁴ This maximizes the number of suits brought (and thereby deterrence), as well as the portion of the recovery from the suits that class members keep (and thereby insurance). Thus, in some sense, reverse auctions are both an optimal and a general solution to the fee problem in class actions.

Nonetheless, although district courts have occasionally attempted reverse auctions over the years, they have not been adopted in even a small percentage of cases.⁹⁵ The reasons for this are multifold. For one thing, to ensure that the class is well represented, courts need to consider the quality as well as the price of representation; the differences in quality among lawyers has thereby made it difficult for courts to compare their bids.⁹⁶ For another, courts have found that very few firms bid in auctions, and, as a consequence, they have not been persuaded that reverse auctions create much of a market for representation. Indeed, courts often worry that the bids may reflect collusion among class action lawyers.⁹⁷ In 2001, a task force convened by the Third Circuit carefully examined a decade of experience with reverse

⁹³ *Id.* at 105-07. An alternate form of the proposal would have class counsel or others bid to buy the claim outright from class members. *See id.* at 106-08 (explaining the process for defining and auctioning claims). Charles Silver and Sam Dinkin have similarly proposed auctioning a *share* of the class's claim. *See* Charles Silver & Sam Dinkin, *Incentivizing Institutional Investors to Serve as Lead Plaintiffs in Securities Fraud Class Actions*, 57 DEPAUL L. REV. 471, 500-505 (2008).

⁹⁴ *See* Macey & Miller, *supra* note 42, at 109-10 ("Another advantage of the auction procedure is that, as in the case of any market arrangement, it tends to direct the asset under sale to the most efficient (i.e., highest-valuing) user. . . . [A]n auction should enhance the private enforcement of the law by replacing a party whose interest is only in the profits flowing from the award of fees (the plaintiffs' attorney under the current regime) with a party with a bona fide interest in maximizing the net return to the claim for a party (the winning bidder of the auction process).").

⁹⁵ *See, e.g.*, LAURAL L. HOOPER & MARIE LEARY, FED. JUDICIAL CTR., AUCTIONING THE ROLE OF CLASS COUNSEL IN CLASS ACTION CASES: A DESCRIPTIVE STUDY 3 (2001), [http://www.fjc.gov/public/pdf.nsf/lookup/auctioning.pdf/\\$file/auctioning.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/auctioning.pdf/$file/auctioning.pdf) ("[C]ourts have auctioned the role of class counsel in fourteen cases—twelve securities and two antitrust actions.").

⁹⁶ *See* McCandless et al., *supra* note 33, at 480-81 (reviewing reasons for eschewing auctions, including the "apples and oranges problem" in comparing competing bids).

⁹⁷ *See* Macey & Miller, *supra* note 42, at 111-12 (noting these concerns, but arguing that criminal and disciplinary penalties should deter collusion).

auctions and concluded that they were useful only under “limited circumstances.”⁹⁸ Consequently, courts rarely use reverse auctions.⁹⁹

Other commentators have stepped into the void left by the rejection of the Macey-Miller proposal and have suggested tweaks to class action fee practice that are consistent with deterrence-insurance theory. For example, Bruce Hay has argued that, in order to better induce class counsel to settle class actions for their full value, judges should award class counsel the same percentage in fees when counsel settle class actions as they would have awarded if the class actions had been resolved at trial.¹⁰⁰ If judges award higher percentages in settlements than in trial judgments, then class counsel will settle cases for less than defendants might have paid at trial. If we assume, as we often do, that trial judgments set damages equal to the harm caused by defendants,¹⁰¹ then awarding higher percentages in settlements than in trials would undermine the deterrence function of class actions.

Similarly, Myriam Gilles and Gary Friedman have argued that courts should not use the so-called lodestar cross-check when they decide what percentage of a small-stakes class action judgment to award to class counsel.¹⁰² Gilles and Friedman explain that using the lodestar cross-check effectively caps the amount of compensation class counsel can receive from a judgment, blunting the incentives for class counsel to achieve the largest possible award for the class.¹⁰³ This, too, threatens the deterrence function of class actions insofar as attorneys no longer have the incentive to fight for judgments that force defendants to fully internalize the costs of the injuries they caused the class.¹⁰⁴ Consequently, Gilles and Friedman argue that, to avoid blunting the incentives of class counsel in this way, courts should use the percentage-of-the-recovery method to award fees without a lodestar cross-check.¹⁰⁵

⁹⁸ Third Circuit Task Force on Selection of Class Counsel, *supra* note 2, at 726.

⁹⁹ See, e.g., Vaughn R. Walker & Ben Horwich, *The Ethical Imperative of a Lodestar Cross-Check: Judicial Misgivings About “Reasonable Percentage” Fees in Common Fund Cases*, 18 GEO. J. LEGAL ETHICS 1453, 1469 (2005) (noting that courts have “largely rejected” the reverse-auction proposal).

¹⁰⁰ See Hay, *supra* note 3, at 1467 (“The optimal fee cap is simply equal to the fee-compensation ratio that would obtain if the case went to trial.”).

¹⁰¹ See *infra* note 120.

¹⁰² See Gilles & Friedman, *supra* note 65, at 142 (“[T]he lodestar cross-check may ‘protect’ class members against windfall attorneys’ fees, but it seriously undermines the value of deterrence . . .”).

¹⁰³ See *id.* at 140-42.

¹⁰⁴ *Id.* at 142-45.

¹⁰⁵ See *id.* at 140-42 (“[T]he demonstrable reality is that the vaunted lodestar cross-check ensures suboptimal deterrence.”).

The arguments made by Gilles and Friedman, as well as Hay, are compelling from the perspective of deterrence-insurance theory, but none instructs courts on *what* percentage they should choose in the first instance. That is, Hay does not instruct courts what percentage they should select in both settlement and trial judgments, and Gilles and Friedman do not instruct courts on what percentage they should select when they award fees unhindered by the lodestar cross-check. Consequently, and in light of the rejection of the Macey-Miller proposal, judges who award fees in class actions have been left at something of a normative sea. As discussed above, this has led courts to award fees more or less arbitrarily.

At the same time, it should be noted that there is one factor that empirical studies have repeatedly shown to influence consistently and significantly the fees that courts award in class actions: the size of the settlement. Courts award smaller fee percentages in cases with larger class judgments.¹⁰⁶ As I noted above, this inverse relationship between fee percentage and settlement size might be defended from the deterrence-insurance perspective on the ground that class counsel's costs of litigating an action do not scale up as quickly as the size of the settlement does. That is, in light of the economies of scale of class action litigation, courts might be able to induce class counsel to bring large class actions at lower percentages than small class actions.¹⁰⁷ Although I believe that, as a general matter, this inverse relationship is consistent with deterrence-insurance theory, a relationship that tells courts to award attorneys lower percentages in some cases than others still does not tell courts *what* percentage to award in the some cases or the other cases. Moreover, as I explain in the next section, deterrence-insurance theory would not necessarily endorse this inverse relationship in all sorts of class actions. Indeed, in small-stakes class actions, which may make up a majority of all class actions, deterrence-insurance theory suggests that courts should not lower fee percentages no matter how large the aggregate class recovery may be.

C. *How Deterrence-Insurance Theory Can Help Courts Award Fees in Class Actions*

It should be noted at the outset that deterrence-insurance theory alone may not be able to provide courts additional assistance in setting fee percentages in all types of class actions. This is because, as I

¹⁰⁶ See Fitzpatrick, *supra* note 6 (manuscript at 31).

¹⁰⁷ See *supra* note 56.

noted above, the deterrence function of litigation clashes with its insurance function when courts decide how to split judgments between the class and class counsel. If we give class counsel more of the judgment, we increase deterrence but decrease insurance. If we give class counsel less of the judgment, we increase insurance but decrease deterrence. To decide whether to prioritize deterrence or insurance, and how much to prioritize one over the other, we would need to have, on the one hand, data regarding how risk averse class members are with respect to the injuries in a given case (so we know how much utility they gain if we lower attorneys' fees), and, on the other hand, data regarding the cost structure for bringing the case (so we know how likely it is that the case would not be brought at all if fees were lowered). We do not have, and never will have, such data. This means that, apart from the reverse-auction proposal, the question of how class judgments should be split between class counsel and the class cannot be answered in the abstract by applying theory alone.

There is, however, one type of class action for which I believe deterrence-insurance theory alone can provide additional guidance in setting fees. Luckily, it is the type of class action that is perhaps the most prevalent: the small-stakes class action. In a small-stakes class action, each individual class member stands to recover very little from the class action judgment, perhaps only a few dollars or a few hundred dollars. Many nonsecurities class actions fall into this category, and even in federal court, which is the exclusive province of securities class actions, nonsecurities cases comprise over 60% of the class action docket.¹⁰⁸

What is special about the small-stakes class action is that it serves no insurance function whatsoever. Rather, as I explain below, its only purpose is deterrence. This means that the question of how to split small-stakes class judgments presents no tradeoff between deterrence and insurance and, therefore, can be answered by looking to deterrence alone.

Small-stakes class actions serve no insurance function because individuals are not risk averse with respect to small losses. That is, a loss of a few dollars or a few hundred dollars does not appreciably affect the marginal utility an individual derives from additional wealth.¹⁰⁹ Accordingly, individuals are indifferent between, say, a loss of \$1 and a 1% chance of losing \$100. This indifference means that neither individual nor social welfare is enhanced by transferring wealth from the

¹⁰⁸ See Fitzpatrick, *supra* note 6 (manuscript at 11 tbl.1).

¹⁰⁹ See SHAVELL, *supra* note 60, at 186-99 (noting that an individual is relatively indifferent to a risk if it involves a potential loss that is small in relation to that person's income).

no-injury state to the injury state of the world.¹¹⁰ In fact, when the administrative costs and profit margins of providing insurance are added to the equation, it is actually irrational for individuals to buy insurance against losses for which they are not risk averse.¹¹¹ This is why we do not often observe individuals buying insurance against small losses, and, indeed, observe individuals exempting small losses from the insurance they do buy in the form of deductibles.¹¹²

In other words, the only function small-stakes class actions serve is deterrence. Although it does not enhance social welfare to insure plaintiffs against small-stakes losses, it does enhance social welfare to optimally deter defendants from causing those losses in the first place. Indeed, small-stakes class actions serve an especially important deterrence role because if small-stakes claims are not brought to court through the class action device, they will not be brought at all, and defendants will not internalize any of the costs of causing small harms. This would leave defendants with little reason to try to avoid causing these harms, even when the benefits do not outweigh the costs.

One might ask why it is utility enhancing for individuals to pay to prevent future small-stakes losses from occurring in the first place (i.e., to buy deterrence), if it is not utility enhancing for those individuals to pay to make themselves whole when such losses occur (i.e., to buy insurance). The answer is that deterrence is a better deal than insurance. The price individuals pay for deterrence is equal to the cost of the precautions defendants must take in order to avoid causing the losses for which they would be legally liable. By definition, this price is always less than or equal to the expectation value of the losses that would have otherwise been incurred; as such, it makes individuals better off to pay this price no matter whether the losses are small or large. By contrast, the price individuals pay to insure themselves fully is always greater than the expectation value of the losses they have incurred (because they must be made whole plus, as noted above, pay administrative costs—in this case a fee to an attorney—to facilitate the insurance). It is only utility enhancing for individuals to pay an amount

¹¹⁰ See *id.*; Jois, *supra* note 67, at 284 (“[I]n the context of relatively small losses . . . , the insurance function of tort law is not relevant.”).

¹¹¹ See SHAVELL, *supra* note 60, at 198 (“Where the correlation or size of risks, administrative costs, or problems with incentives are sufficiently important, the expected utility maximizing amount of coverage may be none at all.”).

¹¹² See *id.* (noting that deductibles reduce administrative costs while protecting individuals against large losses, “which is what insureds care about most, being risk averse”).

above and beyond the expectation value of their losses if they are risk averse with respect to those losses—i.e., if the losses are large.¹¹³

The idea that small-stakes class actions serve only a deterrence function is not a new one. Although most commentators who have noted this have considered only whether small-stakes class actions also serve the nonutilitarian function of compensation, as opposed to the utilitarian function of insurance, the points are similar. David Shapiro, for example, has noted that

the small claim class action . . . serves the purpose not of compensating those harmed in any significant sense, . . . but rather, and perhaps entirely, the purpose of allowing a private attorney general to contribute to social welfare by bringing an action whose effect is to internalize to the wrongdoer the cost of the wrong. The purpose of the action, in other words, is solely to deter the kind of wrong that causes a small injury to a large number.¹¹⁴

Miriam Gilles and Gary Friedman made the same observation in their article advocating no longer using lodestar cross-checks to set fee percentages in small-stakes class actions.¹¹⁵ They noted that “the right to seek compensation ceases to be meaningful (viewed *ex ante*) when the value of the potential claim is low.”¹¹⁶ Accordingly, they argue that “the primary goal in small-claims class actions is deterrence, and that the only question we should ask with respect to any rule or reform proposal in this area is whether it promotes or optimizes deterrence.”¹¹⁷

These commentators have not, however, considered the implications of this view for the proper split of small-stakes judgments between the class and class counsel. If, in small-stakes cases, the deterrence-insurance theory of litigation essentially reduces to the deterrence theory of litigation, then this frees the question of how judgments should be split between class counsel and the class from the aforementioned empirically contingent tradeoffs that normally attach to the question. It permits us to make conclusions about the proper split between the class and class counsel from theory alone. And what does theory suggest? I believe it suggests that if the substantive law correctly sets damages for the claims on which small-stakes class actions are based equal to the total costs of the injuries the de-

¹¹³ See *id.* at 186-99.

¹¹⁴ Shapiro, *supra* note 74, at 924.

¹¹⁵ See Gilles & Friedman, *supra* note 65, at 132-36 (explaining “why compensation just does not matter”).

¹¹⁶ *Id.* at 136.

¹¹⁷ *Id.* at 139.

fendants caused in those actions, then the optimal split of small-stakes judgments is 100% for the lawyers and nothing for class members. If class action lawyers receive any less than that, then some cost-justified class actions will not be filed because class counsel cannot recover their expected litigation costs.

For example, if class action lawyers receive only 25% of class action judgments, as they generally do now, then class actions that cost between 25% and 100% of the expected judgment to litigate will not be filed. This means that defendants will never be forced to internalize the harms they cause in such cases. In order to optimally deter defendants, class action lawyers need to be fully incentivized to invest in as many class actions as are cost justified. The only way to incentivize them fully is to give them 100% of the return on their investment.

It is true that, as a general matter, any time contingency-fee lawyers receive less than 100% of a recovery, some cost-justified actions do not go forward.¹¹⁸ But, again, what is special about small-stakes claims is that there is no corresponding gain in insurance when contingency-fee lawyers receive less than 100%. Thus, there is no reason from deterrence-insurance theory to give them any less.¹¹⁹

As I noted above, the conclusion that deterrence-insurance theory suggests that class action lawyers should be fully incentivized to bring small-stakes class actions by taking 100% of their judgments is based on the assumption that the substantive law correctly assesses damages for the claims on which small-stakes class actions are based. Much of the law and economics literature on civil litigation makes this assumption,¹²⁰ but if the assumption is not realistic, and courts systematically assess damages in excess of the social costs of the injuries defendants cause, then fully

¹¹⁸ See, e.g., Macey & Miller, *supra* note 42, at 24 ("The attorney operating in a percentage-of-the-recovery system will never bring an action when the expected opportunity costs to the attorney of bringing the suit (as measured by the value the attorney places on his or her time) exceed the expected award of attorneys' fees (equal to the present value of the expected recovery for the class multiplied by the fee percentage used in the jurisdiction and further discounted by the attorney's estimate of the probability of success in the litigation).").

¹¹⁹ It should be noted that, just because class members are giving away their entire claim, it does not mean that they are made worse off. It is much cheaper to deter losses from occurring in the first place by allowing class action lawyers to threaten suit credibly whenever these losses occur than actually to sue, recover, and distribute compensation for losses that do occur. See Rosenberg, *supra* note 66, at 1891 ("Everyone is made worse off, *ex ante*, when the legal system deploys scarce resources to insure, rather than prevent, unreasonable risk. By definition, the costs of preventing unreasonable risk are lower than the costs of compensating loss resulting from such risk.").

¹²⁰ See, e.g., Polinsky & Shavell, *supra* note 73, at 896 ("[W]e have assumed that when parties are found liable, they pay for all of the harm that they have caused.").

incentivizing class action lawyers to bring every cost-justified suit could result in over-, rather than optimal, deterrence of defendants.¹²¹

It is difficult to say whether the substantive law in the subject areas in which small-stakes class actions are most prevalent (e.g., consumer fraud and labor-management relations) systematically overassesses damages against defendants. To the extent statutory texts or jury verdicts in these areas do not perfectly assess damages, I am not sure why there would not be just as many downward deviations from optimal damages as upward deviations.¹²² That is, in the absence of some empirical evidence or theoretical account that shows that the substantive law in one area or another systematically overassesses damages, I am not sure why we would assume that it does. Moreover, even if the substantive law were not assessing damages equal to the social costs of activities, the proper response might be to confront that problem directly by changing the substantive law, as opposed to trying to confront it indirectly by offsetting the weaknesses in the substantive law with adjustments to attorney-compensation rates.

For example, although they are not paradigmatic small-stakes class actions, many commentators believe that securities fraud actions systematically overassess damages because defendants must pay for all of the losses investors suffered without any adjustment for all of the gains the fraud caused other investors.¹²³ Similarly, some commentators be-

¹²¹ In light of the fact that defendants may escape liability for harms that they cause, some commentators have noted that defendants should pay more than the cost of those harms when they are found liable to ensure that defendants fully internalize the cost of their activities. See *id.* at 954. Other commentators have noted that it is difficult to set damages in this way because the frequency with which defendants will escape liability is itself a function of the expected damages award. See, e.g., William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1, 15 (1975) (worrying that this interdependence might lead to “overenforcement”).

¹²² Indeed, the law rarely provides any compensation at all for many components of injuries, such as many psychological harms, transaction-cost harms, and sentimental-value harms. Thus it may be more likely that the substantive law understates damages than overstates damages. See, e.g., SHAVELL, *supra* note 60, at 133-35 (arguing that “the magnitude of liability” should equal “the sum of pecuniary and nonpecuniary losses,” but that Anglo-American tort law does not recognize some nonpecuniary losses); cf. Robert A. Mikos, “Eggshell” Victims, Private Precautions, and the Societal Benefits of Shifting Crime, 105 MICH. L. REV. 307, 320-39 (2006) (discussing this problem in the context of criminal law).

¹²³ The criticisms of securities fraud class action are ubiquitous. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 639-40 (1985) (arguing that, because for every investor who lost money in a secondary market case, there is another investor who profited, the social harm is less than the sum of all investor losses); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 646 (1996) (arguing that there will be “systematic overcompensation” from securities fraud litigation if full compensation becomes its goal).

lieve that statutory-damages claims, which do often form the basis of small-stakes class actions, were *designed* to overassess damages because it was assumed that these actions would be brought only a small fraction of the times defendants caused harm (and the possibility of class action litigation, aggregating as it does all the parties who have been harmed by the defendant into one action, seriously undermines this assumption).¹²⁴ But rather than try to offset these overages indirectly by increasing or decreasing attorney-compensation rates, it would seem much less crude, and therefore more effective, to correct the overages directly by amending the statutes setting the parameters of these sorts of claims.¹²⁵

Much the same can be said about the other common arguments that, even now, class action litigation produces overdeterrence. For example, some commentators have argued that defendants overpay to settle class actions because of the risk of an outcome at trial that could bankrupt them.¹²⁶ Others have argued that the cost of discovery can lead defendants to pay large sums to settle even meritless suits.¹²⁷ To

¹²⁴ See Brian T. Fitzpatrick, *The End of Objector Blackmail?*, 62 VAND. L. REV. 1623, 1648 n.100 (2009) ("A utilitarian might also worry that some causes of action, such as those which provide for extra-compensatory statutory damages, were not intended to be fully enforced; as such, further inducing class action lawyers to bring such cases might result in . . . overdeterrence."); see also Richard A. Nagareda, *Aggregation and Its Discontents: Class Settlement Pressure, Class-Wide Arbitration, and CAFA*, 106 COLUM. L. REV. 1872, 1878 (2006) ("[C]lass settlement pressure is most troubling when aggregation would not merely enable the enforcement of cost-prohibitive claims, but in addition, would distort the underlying remedial scheme. The most glaring of these situations arises when a class action would aggregate statutory damages that have been decoupled from claimants' actual losses specifically in order to enable individual litigation. Aggregation of statutory damages in this setting would make for a kind of double counting discordant with the underlying remedial scheme.").

¹²⁵ Some jurisdictions, for example, have prohibited statutory-damages claims actions from being brought as class actions. See, e.g., *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, No. 08-1008, slip op. at 3-16 (U.S. Mar. 31, 2010), available at <http://www.supremecourt.gov/opinions/09pdf/08-1008.pdf> (discussing New York's law).

¹²⁶ See *In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1298-99 (7th Cir. 1995) (Posner, J.) (arguing that class actions lead to "blackmail settlements" because defendants "fear . . . the risk of bankruptcy [and] settle even if they have no legal liability," rather than "stake their companies on the outcome of a single jury trial"). But see Charles Silver, *"We're Scared to Death": Class Certification and Blackmail*, 78 N.Y.U. L. REV. 1357, 1359, 1414-15 (2003) (arguing that there is little to no empirical support for the assertion that class action litigation threatens corporate defendants with bankruptcy, and that the existence of liability insurance suggests that, when not threatened by bankruptcy, corporations will behave in a risk-neutral manner).

¹²⁷ See, e.g., *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 559 (2007) (noting, in a class action case, that "the threat of discovery expense [can] push cost-conscious defendants to settle even anemic cases"); Fitzpatrick, *supra* note 124, at 1648 n.100 ("[A] utilitarian might worry that, despite the fact that class action lawyers are not fully in-

the extent these concerns are problems, it seems much more effective to confront them directly than to address them indirectly by offsetting them with adjustments to attorney-compensation rates. If the problem is that the prospect of a single class action trial is too great for defendants to bear, then the better solution may be to do as many commentators have proposed and sample several trials and average the results.¹²⁸ If the problem is that plaintiffs can run up discovery tabs on defendants, then, as other commentators have noted, the better solution may be to ask plaintiffs to pay for the discovery they request or at least to do so if the discovery they request does not turn up anything.¹²⁹ Again, attempting to raise or lower the percentage of class action settlements in order to solve these much broader problems strikes me as inefficient and largely ineffectual.¹³⁰

To give class counsel more from small-stakes judgments, courts will, of course, need to determine which judgments are small stakes and which judgments are not. This may not be easy. The key consideration is at what magnitude of loss individuals become risk averse, and the answer to this question may vary across individuals: wealthier individuals may become risk averse at different points than poorer individuals, and some individuals have a greater taste for risk than oth-

centivized, they still might be filing too many class action cases on account of the fact that they can extract a premium from defendants who, eager to avoid . . . the considerable costs of litigating, . . . will settle cases for more than their expected value . . .").

¹²⁸ See generally Michael J. Saks & Peter David Blanck, *Justice Improved: The Unrecognized Benefits of Aggregation and Sampling in the Trial of Mass Torts*, 44 STAN. L. REV. 815, 851 (1992) (concluding, after a thorough investigation of aggregated trials, that the practice "can increase efficiency, . . . systematically increase accuracy, reduce bias, and still provide meaningful individualization of awards"); Edward F. Sherman, *Segmenting Aggregate Litigation: Initiatives and Impediments for Reshaping the Trial Process*, 25 REV. LITIG. 691, 696-702 (2006) (discussing the use of "bellwether cases" and "sample trials").

¹²⁹ See, e.g., Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435, 452-54 (1994) (discussing the possibility of eliminating abuse in discovery by shifting costs of complying with a discovery request to the party that made it).

¹³⁰ It is true that defendants who settle or lose class actions have to pay fees to their own lawyers in addition to the money they must pay to the class and to class counsel. This additional expense means that, even when the substantive law sets damages such that they do not exceed the total harms caused by defendants, defendants might nonetheless end up systemically overdeterred if class action lawyers are fully incentivized to bring every cost-justified action. On the other hand, as I noted above, it is probably the case that the substantive law systematically underassesses damages, and this underassessment may more than offset the litigation expenses defendants incur. See *supra* note 122. In any event, as I explain in the next Part, it is unlikely, for practical reasons, that judges will be able to incentivize class action lawyers fully. As such, to the extent any overdeterrence concern remains, it may be purely theoretical.

ers.¹³¹ Nonetheless, there are presumably levels of loss for which the vast majority of the population exhibits little to no risk aversion. Class actions in which class members stand to gain no more than a few dollars, or even a few hundred dollars—which, again, is likely to comprise a large portion of the nonsecurities docket—would seem to fall well within this category.

It is true that there are “mixed” class actions in which some class members have little to gain while others have much to gain. Many securities fraud class actions, which usually include both small and institutional investors, may fall into this category. It would undermine the insurance goals of litigation to give class counsel 100% of these settlements because it would enhance social welfare to compensate the large-stakes class members. Rather, in mixed cases, deterrence-insurance theory might suggest something more akin to giving class counsel 100% of the settlement proceeds earmarked for small-stakes class members but a smaller percentage of proceeds earmarked for large-stakes class members.

Of course, that judges should, as a theoretical matter, award all of small-stakes settlements to class counsel does not mean they can or will. In the next Part, I take up the practical limitations of the deterrence-insurance solution to class action fee awards.¹³²

¹³¹ See SHAVELL, *supra* note 60, at 187-89.

¹³² One might ask how we will find class members to serve as representative plaintiffs if they receive no compensation from the settlement. This problem already exists in small-stakes class actions because, even when class members are compensated, the stakes in the actions are so small that it is hardly worth their while to participate. We solve this problem now by paying class members to participate as representatives through incentive payments. See Theodore Eisenberg & Geoffrey P. Miller, *Incentive Awards to Class Action Plaintiffs: An Empirical Study*, 53 UCLA L. REV. 1303, 1307 (2006) (noting in a study of “374 opinions in class action settlements published from 1993 to 2002,” that “[i]ncentive awards were granted in about 28 percent of the sample”). There is no reason we could not continue such a practice and still give class counsel 100% of what remains after the incentive payments are distributed. A related question is whether class members will come forward and object to small-stakes settlements when class counsel has, for example, sold out the class for a quick buck if class members stand to gain nothing from such settlements. This problem also already exists in small-stakes settlements. Class members have so little at stake, even when they do receive something, that it is rarely worth their while to file objections. The solution is to do as the American Law Institute recommends and pay objectors and their lawyers for bringing forward meritorious objections. See PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 3.08(a) (Proposed Final Draft 2009) (“The court may . . . award attorneys’ fees out of a common fund for efforts made by attorneys on behalf of objecting class members in materially improving the settlement for the class or any subclass . . .”).

III. THE PRACTICAL LIMITATIONS ON AWARDING FEES TO CLASS COUNSEL

It goes without saying that it would be politically difficult for judges to award fees equal to 100% of small-stakes class judgments even if they had the legal authority to do so. As I noted at the outset of this Article, the conventional wisdom is that lawyers are already reaping too much money from class actions. Judges who sought to give them 100% of settlements would probably incur the ire of the political branches or the public. This would make it especially hard for state judges who are elected or serve without life tenure to follow deterrence-insurance theory to its logical conclusion.

Thus, there is undoubtedly a political ceiling on how high judges can go on fee awards. Where exactly this ceiling is located is unclear. I understand that there is something of a professional norm among contingency-fee lawyers that they should not recover more than their clients do, which may make 50% the practical limit on fees in class action cases. Indeed, it is interesting to note that, in the two years of federal court class action settlements I studied, no court setting fees on the basis of a percentage of the settlement awarded class counsel more than 50%, with the highest award at 47%.¹³³ It is possible that judges will not be inclined to award fees any higher than that in the near future, no matter how small the stakes of each class member and no matter how compelling the logic from deterrence-insurance theory.

Moreover, even if judges had the political freedom to do so, it is possible that legal or ethical constraints would prevent judges from awarding fees beyond these levels. It is possible that there would be problems with standing if judges actually awarded 100% of class action judgments to class counsel because it would be arguable that no class member would have a stake in the action. Moreover, the common law of unjust enrichment, which, again, supplies the substantive legal basis to share the class's judgment with class counsel,¹³⁴ might not permit giving the entire judgment to class counsel.

Indeed, it is not entirely clear how high judges could go even short of 100% in light of existing legal constraints. On the one hand, the Federal Rules of Civil Procedure and most state rules of procedure empower judges in class actions to award class counsel whatever fee is

¹³³ See Fitzpatrick, *supra* note 6 (manuscript at 29).

¹³⁴ See Silver, *supra* note 30, at 657.

“reasonable,”¹³⁵ and as I noted in Part I, this gives judges a great deal of discretion over what fees to award. To the extent that deterrence-insurance theory provides a rational basis for awarding fees as high as even 100% of the judgments in small-stakes class actions, these rules of procedure might permit judges to award fees as high as they wish. On the other hand, the federal government and the states regulate to some extent the contingency fees that lawyers can collect when they win cases, and it is possible that these regulations tie the hands of state, and perhaps even federal, judges. The statutes and regulations enacted at the federal level cap contingency fees at particular percentages for various types of cases,¹³⁶ but none of these cases is likely to give rise to many class actions. As for the states, many have adopted the ABA’s Model Rule generally prohibiting “unreasonable” fees,¹³⁷ but, again, to the extent there is a rational basis for a contingency fee as high as even 100% in small-stakes class actions, it is possible that these rules would permit large awards. Some states have adopted more precise limits on contingency fees, capping them at particular percentages in certain types of cases,¹³⁸ or, as in Oklahoma, capping

¹³⁵ See FED. R. CIV. P. 23(h) (“In a certified class action, the court may award reasonable attorney’s fees . . .”).

¹³⁶ See 22 U.S.C. § 1623(f) (2006) (capping fees in claims before the Foreign Claims Settlement Commission at no more than “10 per centum of the total amount paid pursuant to any award”); 28 U.S.C. § 2678 (2006) (capping fees at no more than “25 per centum of any judgment” or “20 per centum of any award, compromise, or settlement” in tort claims against the United States); 31 U.S.C. § 3721(i) (2006) (capping fees with respect to claims against personnel of agencies and the District of Columbia government for personal property damage or loss); 38 U.S.C. § 1984(g) (2006) (capping fees with respect to Veterans’ Affairs insurance claims); *Id.* § 5904(a)(5) (allowing limitations on fees for claims before the Department of Veterans’ Affairs); 42 U.S.C. § 406 (2006) (limiting fees for claims before the Commissioner of Social Security); 50 U.S.C. app. § 20 (2006) (limiting fees under the Trading with the Enemy Act); *Id.* § 1985 (capping fees in American-Japanese evacuation claims); 20 C.F.R. § 404.1730 (2009) (capping fees for Social Security disability claims).

¹³⁷ See Charlotte K. Stretch & Susan M. Campbell, *State Committees Review and Respond to Model Rules Amendments 3-5* (2007), available at http://www.abanet.org/cpr/jclr/review_art.pdf (reporting that thirty states have adopted the ABA’s prohibition of “unreasonable” fees, six states (plus Florida, with a slight variation) prohibit “excessive or illegal” fees, and five states retain the old Model Rule language that a lawyer’s fee “shall be reasonable”) (updating Charlotte K. Stretch, *State Committees Review and Respond to Model Rules Amendments*, PROF. LAW., Spring 2004, at 14, 14).

¹³⁸ See, e.g., CAL. BUS. & PROF. CODE § 6146(a) (West 2003) (capping fees in medical malpractice cases along a sliding scale); CONN. GEN. STAT. § 52-251c(b) (2009) (capping fees in personal injury, wrongful death, and property damage cases on a sliding scale); DEL. CODE ANN. tit. 18, § 6865 (1999) (setting a slide scale for maximum fees in medical malpractice cases); FLA. STAT. § 73.092(c) (2009) (establishing a schedule of fees for eminent domain proceedings); FLA. STAT. § 768.28(8) (2009) (capping

fees at a particular percentage in all cases.¹³⁹ It is possible that these caps would prevent state judges from awarding fee percentages as high as they wish, but, with the exception of the rare contingency-fee caps in states like New Jersey¹⁴⁰ (whose class action cap applies only to tort cases) and Colorado¹⁴¹ (whose class action cap applies only to actions against public entities), none of these caps applies explicitly to class actions as opposed to merely individual cases. Thus, it is not clear that these caps would prevent judges from awarding fees consistent with deterrence-insurance theory outside a subset of cases in a small number of states.

Indeed, even where the caps apply to class actions, they might not restrict the fee-award practice of federal judges. Even when the class actions are based on state law claims, the doctrine set forth in *Erie Railroad Co. v. Tompkins*¹⁴² might permit the Federal Rules of Civil Procedure to override state law because setting the compensation for class action lawyers constitutes a matter that is “arguably procedural.”¹⁴³

fees at 25% for tort actions); FLA. STAT. ANN. Bar Rule 4-1.5(f)(4)(B)(i) (West 2008) (setting a sliding scale above which fees in tort cases are presumed to be excessive); HAW. REV. STAT. § 662-12 (1993) (limiting fees to 25% in tort cases); KAN. STAT. ANN. § 44-536 (2000) (capping fees in workers’ compensation cases at 25%); MICH. CT. R. 8.121(B) (capping fees in personal injury and wrongful death cases at 33%); N.J. CT. R. 1:21-7(c) (capping fees in tort cases along a sliding scale); N.Y. JUD. CT. ACTS LAW § 474-a (McKinney 2008) (setting a sliding scale for medical malpractice fees); TENN. CODE ANN. § 29-26-120 (2000) (capping fees in medical malpractice cases at 33%); TEX. LAB. CODE ANN. § 408.221(i) (Vernon 2006) (capping fees in workers’ compensation cases at 25%); WIS. STAT. § 655.013(1m) (2009) (limiting fees in medical malpractice cases). See generally Lester Brickman, *The Market for Contingent Fee-Financed Tort Litigation: Is It Price Competitive?*, 25 CARDOZO L. REV. 65, 92 n.105 (2003) (compiling state rules and statutes providing sliding-scale or maximum limitations on contingent fees).

¹³⁹ See OKLA. STAT. tit. 5, § 7 (2010) (capping all fees at 50%).

¹⁴⁰ See N.J. R. CT. 1:21-7(i); see also Maria Vogel-Short, *Lawyers’ Fees Capped at 32 Percent of \$4.85 Billion Vioxx Settlement*, N.J. L.J., Sept. 1, 2008, at 5 (explaining that a federal judge in New Orleans cited New Jersey contingency-fee caps when he limited contingency fees to 32% of a settlement).

¹⁴¹ See COLO. REV. STAT. § 13-17-203 (2008).

¹⁴² 304 U.S. 64 (1938).

¹⁴³ *Hanna v. Plumer*, 380 U.S. 460, 476 (1965) (Harlan, J., concurring); see also *id.* at 464 (majority opinion) (“The test must be whether a rule really regulates procedure . . .” (quoting *Sibbach v. Wilson & Co.*, 312 U.S. 1, 14 (1941))); cf. *In re Lease Oil Antitrust Litig.*, No. 1206, 2007 WL 4377835, at *15-16 (S.D. Tex. Dec. 12, 2007) (discussing the effect of *Erie* on the disposition of unclaimed class action funds and “find[ing] that the disposition of unclaimed funds in a class action in federal court is properly classified as procedural. Federal law governs, and therefore the disposition of the unclaimed funds is a matter within the discretion of [the federal court].”); Ethan D. Millar & John L. Coalson, Jr., *The Pot of Gold at the End of the Class Action Lawsuit: Can States Claim It as Unclaimed Property?*, 70 U. PITT. L. REV. 511, 514-15, 544-47 (2009) (concluding that in federal class actions where the settlement provides that the defen-

Indeed, even apart from Rule 23, federal courts have long believed they have the “inherent power” to regulate the contingency fees of the lawyers who practice before them.¹⁴⁴ In light of the fact that the Supreme Court has ruled that a similar “inherent power” to sanction attorneys for misconduct overrides state law to the contrary,¹⁴⁵ it would not be surprising if federal courts concluded that Rule 23 and courts’ inherent power to regulate the compensation of class counsel similarly trump state restrictions on contingency fees. On the other hand, to the extent that Rule 23 or the inherent powers of the federal courts merely *permit*, as opposed to *compel*, federal judges to award large fee percentages to class counsel, federal courts might hold, as they did with respect to Rule 3 in *Walker v. Armco Steel Corp.*, that there is no “direct collision” between federal and state law¹⁴⁶ and that, consequently, federal judges should follow the specific commands of state law as opposed to the more general prescriptions of federal law.¹⁴⁷ The Supreme Court’s recent *Erie* pronouncements in *Shady Grove Orthopedic Associates, P.A. v. Allstate Insurance Co.*¹⁴⁸ did not shed a great deal of light on how these questions would be resolved. Although the Court held that Rule 23 trumped a New York law that prohibited statutory-penalty cases from being certified as class actions,¹⁴⁹ the Su-

dant is entitled to any unclaimed funds, states should not be able to take the unclaimed funds because state “unclaimed property laws are procedural rules that should be preempted by the Federal Rules of Civil Procedure, the *Erie* doctrine, and federal decisions granting the courts broad discretion to approve (and disapprove) class action settlement agreements”).

¹⁴⁴ See, e.g., *In re A.H. Robins Co.*, 86 F.3d 364, 373 (4th Cir. 1996) (“Because contingency fee arrangements are of special concern to the courts and are not to be enforced on the same basis as are ordinary commercial contracts, courts have the power to monitor such contracts either through rule-making or on an ad hoc basis.” (citation omitted) (quoting *Allen v. United States*, 606 F.2d 432, 435 (4th Cir. 1979))); *In re Vioxx Prods. Liab. Litig.*, 574 F. Supp. 2d 606, 610-14 (E.D. La. 2008) (concluding that the court had both equitable and inherent authority to examine the reasonableness of contingent fees); *In re Zyprexa Prods. Liab. Litig.*, 424 F. Supp. 2d 488, 492-93 (E.D.N.Y. 2006) (“A federal court may exercise its supervisory power to ensure that fees are in conformance with codes of ethics and professional responsibility even when a party has not challenged the validity of the fee contract.”).

¹⁴⁵ *Chambers v. NASCO, Inc.*, 501 U.S. 32, 51-55 (1991).

¹⁴⁶ 446 U.S. 740, 749-52 (1980).

¹⁴⁷ Cf. *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 549 F.3d 137, 143 (2d Cir. 2008) (holding that a New York law preventing class actions in statutory damages cases did not directly conflict with Rule 23), *rev’d*, No. 08-1008, slip op. (U.S. Mar. 31, 2010), <http://www.supremecourt.gov/opinions/09pdf/08-1008.pdf>.

¹⁴⁸ No. 08-1008, slip op. (U.S. Mar. 31, 2010), <http://www.supremecourt.gov/opinions/09pdf/08-1008.pdf>.

¹⁴⁹ See *id.* at 14.

preme Court read Rule 23 to require certification of any class action meeting its prerequisites, thus clearly creating a “direct collision” with the New York law forbidding such certification.¹⁵⁰

Even if political and legal considerations prevent judges from awarding fees as high as deterrence-insurance theory suggests, this does not mean that deterrence-insurance theory cannot help judges set fees in small-stakes cases. Insofar as deterrence is the only goal in such cases, the theory suggests that, even if political or legal constraints preclude courts from fully incentivizing lawyers to bring small-stakes class actions, they nonetheless ought to incentivize lawyers *as much as legal and political constraints permit*. That is, deterrence-insurance theory suggests that judges ought to give class counsel as much of small-stakes judgments as they can. If that is 49%, then, although not optimal, it is still much better than the typical award under current practice, 25%.¹⁵¹

I wish to close by noting that, to the extent judges should try to award as much of small-stakes judgments as they can to class counsel, there may be opportunities to do so beyond simply increasing fee percentages towards 50%. For example, there are often leftover settlement proceeds in small-stakes actions because these settlements are difficult or impossible to distribute to class members.¹⁵² There are a variety of reasons for this: sometimes it will cost more to send class members their compensation than the judgment itself provides;¹⁵³

¹⁵⁰ See *id.* at 5.

¹⁵¹ See Fitzpatrick, *supra* note 6 (manuscript at 29).

¹⁵² See, e.g., Susan Beth Farmer, *More Lessons from the Laboratories: Cy Pres Distributions in Parens Patriae Antitrust Actions Brought by State Attorneys General*, 68 FORDHAM L. REV. 361, 391-99 (1999) (discussing the cy pres doctrine as applied to class actions); Gail Hillebrand & Daniel Torrence, *Claims Procedures in Large Consumer Class Actions and Equitable Distribution of Benefits*, 28 SANTA CLARA L. REV. 747, 761-73 (1988) (examining procedures for distributing class action judgments); Jois, *supra* note 67, at 260 (“[T]he problem of leftover class action funds is widespread, it has not been squarely addressed in the academic literature, and the status quo leaves the door wide open for abuse.”); James J. Park, *Shareholder Compensation as Dividend*, 108 MICH. L. REV. 323, 364 (2009) (suggesting that in securities class actions, courts “pay out any unclaimed settlement funds through a dividend to all shareholders,” whether or not they belong to the class); Natalie A. DeJarlais, Note, *The Consumer Trust Fund: A Cy Pres Solution to Undistributed Funds in Consumer Class Actions*, 38 HASTINGS L.J. 729, 737-48 (1987) (examining the use, benefits, and criticisms of cy pres distributions); Stewart R. Shepherd, Comment, *Damage Distribution in Class Actions: The Cy Pres Remedy*, 39 U. CHI. L. REV. 448, 452-63 (1972) (discussing a number of cy pres distribution methods); Sam Yospe, Note, *Cy Pres Distributions in Class Action Settlements*, 2009 COLUM. BUS. L. REV. 1014 (same).

¹⁵³ See, e.g., Farmer, *supra* note 152, at 393 (“Sometimes funds remain undistributed because the costs of distribution outweigh the individual share to which each . . . group member is entitled.”); Jois, *supra* note 67, at 264 (“[T]he costs of iden-

sometimes the amounts class members are entitled to under the judgment are so small that they do not come forward to claim their awards;¹⁵⁴ and sometimes class members cannot be located.¹⁵⁵ It is not uncommon for the undistributed amounts in small-stakes class actions to total millions of dollars.¹⁵⁶ Under current practices, judges, using the doctrine known as “cy pres,”¹⁵⁷ often give leftover settlement proceeds to charities (preferably, though not always, related in some way to the class action).¹⁵⁸ But deterrence-insurance theory suggests

tifying and notifying the class members may be higher than the amount of their potential recovery, such that notifying the members would deplete the entire fund.”); DeJarlais, *supra* note 152, at 730 (“[I]ndividual damages may be so small that notification and distribution costs exceed the recoverable amount or reduce it to a pittance.”); Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis* 2 (Aug. 7, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1485047> (“[N]otifying individual class members of their right to file a claim into a class wide settlement or award fund will often prove to be both difficult and inefficient.”).

¹⁵⁴ See Jois, *supra* note 67, at 259 (“[A]ll possible plaintiffs may not come forward with their claims”); DeJarlais, *supra* note 152, at 729-30 (“[F]unds may not be distributed because . . . some class members fail to submit a claim.”); Redish et al., *supra* note 153, at 2 (noting that the claims of individual class members “will often be so small that their size fails to justify the effort and expense of pursuing those claims”).

¹⁵⁵ See Jois, *supra* note 67, at 264 (“[F]und administrators may simply not be able to identify all members of the plaintiff class.”); Yospe, *supra* note 152, at 1015 (“Residual funds can remain . . . when class members . . . cannot be located”); Redish et al., *supra* note 153, at 18 (mentioning that in some cases it can be “difficult to find the class members”).

¹⁵⁶ See Jois, *supra* note 67, at 259 (writing that undistributed amounts “sometimes total[] in the tens of millions, or as much as a third of the overall class fund”); Yospe, *supra* note 152, at 1015-16 (discussing three cases in which undistributed amounts totaled \$6 million, \$6 million, and \$2 million); Redish et al., *supra* note 153, at 55 (finding an average undistributed amount of \$5.8 million in forty-seven cases studied).

¹⁵⁷ The cy pres doctrine empowers courts to send a fund that cannot be distributed to class members to “its next best compensation use, e.g., for the aggregate, indirect, prospective benefit of the class.” 3 ALBA CONTE & HERBERT B. NEWBERG, *NEWBERG ON CLASS ACTIONS* § 10:17 (4th ed. 2002).

¹⁵⁸ For example, one judge has sent undistributed settlement proceeds from an antitrust case against modeling agencies to charities that combat eating disorders, see *Fears v. Wilhelmina Model Agency, Inc.*, No. 02-4911, 2005 WL 1041134, at *10-16 (S.D.N.Y. May 5, 2005); one has sent undistributed settlement proceeds from a mass tort case to an animal-rights group, see *In re San Juan Dupont Plaza Hotel Fire Litig.*, No. MDL-0721, 2010 WL 60955, at *2 (D.P.R. Jan. 7, 2010); one has given undistributed settlement proceeds from a compact disc advertised-price antitrust case to the National Guild of Community Schools of the Arts, see *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, No. MDL 1361, 2005 WL 1923446, at *2-3 (D. Me. Aug. 9, 2005); one has awarded \$2 million of undistributed settlement proceeds from a case involving a diabetes drug to a Hasidic Jewish group, Lubavitch Chabad of Illinois, see Adam Liptak, *Doling out Other People's Money*, N.Y. TIMES, Nov. 26, 2007, at A14; and one has even used undistributed settlement proceeds from an antitrust case to endow

another course: perhaps these leftover settlement proceeds should, in the name of increasing deterrence, be given to class counsel instead.

It is true that commentators and courts have proposed other solutions to the problem of leftover settlement proceeds, but it is hard to see how any of them are preferable from the perspective of deterrence-insurance theory. One solution is to return the leftover money to the defendants,¹⁵⁹ but because this may lower the amount defendants must pay to a level below the cost of the harm they caused, it undermines the deterrence function of class action litigation. Commentators have proposed using the leftover money to give even more compensation to the class members who can be located and who do file claims,¹⁶⁰ but, given that it is not generally utility enhancing to *over-insure* individuals who suffer losses,¹⁶¹ it would be especially unfruitful to do so when, as in small-stakes cases, the individuals are not even risk averse to begin with. Finally, some commentators have proposed that courts give the leftover money to the state, on the theory that class members would rather send the money there, in hopes of seeing their taxes lowered or government service enhanced, than to a charity to which they have no connection.¹⁶² Although one commentator has

an academic program at my law school, *see* Jois, *supra* note 67, at 266. *Cf.* Diamond Chem. Co. v. Akzo Nobel Chems. B.V., No. 01-2118, 2007 WL 2007447, at *5 (D.D.C. July 10, 2007) (awarding residual settlement funds from an antitrust case to George Washington University Law School for development of a Center for Competition Law).

¹⁵⁹ *See, e.g.,* Van Gemert v. Boeing Co., 739 F.2d 730, 733 (2d Cir. 1984) (holding a district court's decision to return unclaimed funds to the defendant "fair and equitable"); Farmer, *supra* note 152, at 393 (listing this as one alternative to cy pres distributions); Millar & Coalson, *supra* note 143, at 552 (listing this as one of four options "typically" considered by federal courts); Dejarlais, *supra* note 152, at 749-50 (mentioning this as an alternative to cy pres distribution); George Krueger & Judd Serotta, Op-Ed., *Our Class Action System is Unconstitutional*, WALL ST. J., Aug. 6, 2008, at A13 (advocating this as a better alternative than making cy pres awards to unrelated charities); Redish et al., *supra* note 153 (manuscript at 3) (mentioning it as an alternative).

¹⁶⁰ *See* Farmer, *supra* note 152, at 393 (listing this as another alternative to cy pres distributions); Hillebrand & Torrence, *supra* note 152, at 765 (same); Dejarlais, *supra* note 152, at 755-59 (same); Redish et al., *supra* note 153 (manuscript at 3) (same); *see also* PRINCIPLES OF THE LAW OF AGGREGATE LITIGATION § 3.07(b) (Tentative Draft No. 1, 2008) ("If the settlement involves individual distributions to class members and funds remain after distributions . . . , the settlement should presumptively provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable."); Shepherd, *supra* note 152, at 453 (mentioning this approach as a possibility, but ultimately rejecting it); Krueger & Serotta, *supra* note 159 (advocating this approach).

¹⁶¹ *See* SHAVELL, *supra* note 60, at 186-99 (noting the effects of risk allocation on social welfare).

¹⁶² *See* Hillebrand & Torrence, *supra* note 152, at 764-65 (discussing escheat to the state as one method of cy pres distribution); Jois, *supra* note 67, at 271-72 (same); De-

justified this proposal on the basis of deterrence-insurance theory,¹⁶³ it is hard to see—and the author did not explain—why giving class action recoveries to the general state treasury serves deterrence better than giving the proceeds to the people who must invest in bringing the actions in the first place. In short, to the extent that judges should be looking for places in small-stakes class actions from which they can award class counsel greater fees, the class proceeds often left over in those actions seems like a promising place to start.

Of course, to the extent that the diligence of class counsel, and not merely the diligence of claims' administrators, affects what portion of class action proceeds end up distributed to class members, redirecting undistributed proceeds to class counsel will blunt their incentives to distribute the funds. This may not be much of a problem from the deterrence-insurance perspective because, again, that perspective suggests that it is more important to incentivize class counsel than it is to distribute small-stakes funds in the first place, but, for those unwilling to follow deterrence-insurance theory as far as it goes, it must be acknowledged that redirecting undistributed proceeds to class counsel may have costs as well as benefits.

CONCLUSION

Judges have been given the discretion to award a significant portion of all of the contingency fees lawyers in the United States collect when they set attorneys' fees in a few hundred class action judgments every year. Judges currently appear to award these fees largely in the absence of any normative theory and, instead, on the basis of intuition. As a result, judges tend to award lower fee percentages in class action cases than those negotiated in the competitive market for individual litigation.

Although lower percentages might be justified in large-stakes class actions, current compensation practices underpay class counsel in the small-stakes actions that may comprise most of the class action docket in state and federal court. To maximize social welfare, it is often thought that litigation should both deter defendants from causing harm and insure plaintiffs against those harms when they are not de-

Jarlais, *supra* note 152, at 751-53 (same); Shepherd, *supra* note 152, at 453-58 (same); Krueger & Serotta, *supra* note 159 (same); Redish et al., *supra* note 153 (manuscript at 29) ("The primary alternative to reversion of unclaimed funds to the defendant, absent resort to cy pres, is escheat to the state.").

¹⁶³ See Jois, *supra* note 67, at 271-72 (arguing that escheat to the state would better compensate class members and would better deter defendants).

tered. But small-stakes class actions serve no insurance function; they are only about deterrence. As such, there is little reason as a theoretical matter not to fully incentivize class action lawyers to bring these suits by awarding them the entire class recovery. Although political and perhaps even legal constraints might prevent judges from setting fee percentages at 100% in small-stakes cases, deterrence-insurance theory nonetheless suggests that judges ought to give class counsel as much as they can, which, by any measure, is more than the 25% they usually give now.

* * * * *